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Marching Through Georgia with the U.S. Census

I always travelled with a copy of the census in my saddlebags. I could tell how many inhabitants, how many cultivated acres, how many head of cattle and horses, how many bushels of grain, each county possessed at that time, and so, approximately, how many there would be now, and how long it would subsist my army.

William Tecumseh Sherman,
quoted in the *Nation*, August 3, 1865

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HOLGAR J. JOHNSON

Inflation: Enemy of Growth and Progress

The unstable dollar and its effect upon our high-investment economy

This year of 1960 is an anniversary year—a most important one as far as its influence and impact on the people and on the economy are concerned, but because of its nature hardly a cause for celebration. It was just 20 years ago that the seeds of our present inflation, and the problems that it brought in its wake, were sown. Living costs began to rise in the then early wartime atmosphere; and this has gone on with only occasional interruptions ever since. As a result, the dollar today has a purchasing power of only 48 cents as compared with what it would buy in 1940.

This long erosion in the value of the dollar, paralleled only once before in the nation's history in the first two decades of this century, has slowed down recently. Time alone will tell whether or not this marks a turning point, but it is a fact that there have been two other pauses like this in the last two decades, only to see the cost of living resume its rise as the underlying inflationary pressures were allowed to maintain their strength. Thus concern over the future is both widespread and understandable in the absence of concerted and sustained action to counteract the forces which are sapping the dollar.

We know and can explain how and why inflation started when it did 20 years ago. It was war; and war and inflation have been intimate bedfellows from time immemorial. The record shows that the cost of living rose by 28 percent during the period of active hostilities of World War II between 1940 and 1945. This was followed by an even larger gain, amounting to 32 percent, in the four years after V-J Day as the concealed inflation of the wartime period manifested itself with the removal of controls. On an overall basis, as a result, the cost of living

increased by 70 percent during the decade of the Forties.

The beginning of the decade of the Fifties brought another round of inflation after a brief pause in the 1949 recession. Here, too, there were the extenuating circumstances of war — this time the "brushfire" war in Korea. The impact in this case was less severe and of shorter duration than in the World War II period and early postwar years; even so the cost of living rose by more than 10 percent in the three-year period beginning with 1950, and another bite was taken out of the value of the dollar.

But no simple or ready explanation, despite volumes written by the experts, is available for the third inflationary push which the nation has experienced in the last two decades. That one got underway in the spring of 1956 and lasted until the summer of 1958, a period of more than two years. It added almost 8 percent to the cost of living, piled on top of the two previous rises. With living costs edging up further to new record high levels over the past year, the rise for the decade of the Fifties has been 21 percent.

It is the most recent inflationary push that is most disturbing, for it presented the paradox of a persistent rise in living costs throughout a recession and in the face of such traditional restraints as idle manpower and production facilities, and abundance of all kinds. True, we have been living in a sort of twilight zone between war and peace. Nonetheless, the impact of the cold war on the economy to date and the financial and other pressures it has created are hardly analogous to what happens in a shooting war, particularly in view of the size of our economy.

Thus the preponderant weight of evidence, in my opinion, is that a persistent inflation, if allowed to go on and to feed on itself as has been the case, can infect an economy to such an extent that it can continue to assert itself under unexpected, and seemingly adverse, circumstances so long as it is allowed to persist.

INSURANCE AND INFLATION

We in life insurance recognized this threat to the national welfare in its earliest stages, and have consistently brought it to the attention of the American people. Our record is clear and unequivocal in this respect.

The anti-inflation activities of the life insurance business go back more than a decade and a half, to the participation of the life companies in the government's Program of Economic Stabilization during World War II. There was a second campaign during the Korean War when it was necessary for the public to forego some of the things they wanted as the productive machinery of the nation turned to the war effort.

In the spring of 1957, three years ago, our third anti-inflation campaign was launched, shortly after the 1956-58 inflation got underway. At that time we in life insurance were virtually alone in calling attention to the danger that the resumption of inflation presented to the people and to the economy. Since then the threat to the dollar has become widely recognized. The administration in particular has taken positive action to stabilize the dollar, aided by support of congressmen and senators from both political parties.

Warning Through Publicity

A major part of our anti-inflation activities was a newspaper and magazine advertising campaign carrying messages to the public at large, telling the people what an eroding dollar was doing to their earnings and their savings, how it threatened their future and that of the economy, and suggesting what they could do about it. The campaign was buttressed by supplementary informational activities to policyholders and to the public through the nation's press.

A direct target of our campaign was the dangerous philosophy expounded by inflation apologists that a "little inflation" was inevitable and the price to be paid for continued prosperity and high employment. We have heard such statements made over and over again in recent years. They have secured a wide amount of attention, particularly as some well-known economists and others of important position in public and private life have indicated by words and actions that they subscribe to this school of thought.

A Little Inflation?

Even a rate of about 2 percent a year, which is about the average for the last decade as a whole, would cut the dollar's present buying power in half in another thirty years. That is hardly the kind of legacy the American people would like to leave to their children. And it is a dismal prospect for the shape of our future.

Any premise that inflation can go on creeping at some specified rate year after year, as regularly and as predictably as clockwork, is both unrealistic and the purest nonsense from my point of view. It completely fails to take into account the factors of public psychology and human reaction. It dodges the ominous question of the effect that acceptance of inflation as a way of life will have upon the people's will to save, and thereby to provide the all-important element of capital formation without which the growth of our economy must slow down and eventually grind to a halt. And it ignores the world stake in the dollar, now about on a par with our gold reserves, and the effect that foreign distrust in the dollar's stability can have. We have had some evidence of this in the big drain on our gold holdings in the past two years.

The Eroding Dollar

We in life insurance were naturally motivated in our anti-inflation stand by the impact of an eroding dollar on the value of life insurance protection and benefits. We were, and continue to be, deeply conscious of the fact that so much of life insurance benefit payments every year go to people of small or modest means, those who are most defenseless against the ravages of inflation. Total life insurance protection in force in legal reserve companies amounted to $534 billions at the end of 1959, and benefit payments for the year, excluding accident and health benefits, exceeded $7.5 billions. With 115 million policyholders in legal reserve companies, equivalent to nearly two out of every three persons in the entire population, life insurance is the nation's most widely-held medium of thrift.

Of course life insurance is anything but unique in its exposure to the debilitating effect of inflation and a de-

preciating dollar. Every dollar in every form of savings is as deeply involved, whether it is in an account in a savings bank or in a savings and loan association, or whether it is in U.S. savings and other government bonds or in any security bearing a fixed-interest return. And every pension and retirement benefit is just as vulnerable, whether it comes from a government-sponsored program such as Social Security or whether it is paid by private programs, which have grown so greatly and which now cover such a large part of our working population. That is the way of inflation; it plays no favorites. It deals indiscriminately and heavy-handedly on all sides, without regard to justice or morality, or to the condition of those who are feeling its impact.

An Aging Population

This applies particularly to a steadily increasing part of our population, to those 65 and over, so many of whom are beyond their productive years. The figures are illuminating. Back in 1900 there were just over 3 million persons 65 and over, or about 4 percent of the population. In 1940, when the present inflation got underway, there were 9 million Americans who were 65 and over, or close to 7 percent of the population. But now there are close to 16 million in this age group, or over 8½ percent of the population; and the estimate for 1975, only a decade and a half away, is that there will be around 22 million persons 65 and over, or practically one person out of every ten in the population at that time.

Behind this trend is the great increase in longevity over the years. In 1900 the average expectancy of life at birth for both sexes combined was little more than 47 years. Whatever the financial circumstances, for most people the possibility of retirement was at that time only a mirage. But now, according to the latest figures, the average life expectancy at birth has increased to the Biblical three score and ten. Retirement has become a reality for millions of our older citizens, and the number will increase markedly as time goes on.

These are some of inflation's victims. There are millions of others, those dependent on some form of savings for their principal source of income, or those earning their livelihood as teachers and civil service workers, where incomes are relatively insensitive and slow to respond to changing conditions. To an increasing number of these, persistently rising living costs means hardship, and in some cases even impoverishment.

THE ECONOMY AND INFLATION

But there is another side to inflation that, in its broader and longer-range aspects, is even more disturbing. That is the impact of a steadily depreciating dollar on the course of the economy and its growth potentials. We in life insurance have been acutely conscious of this danger from the very beginning, and it has played a prominent role in our anti-inflation activities.

This threat to the economy and to its future is as inherent in a continuation of creeping inflation, of the type the nation has been experiencing in recent years, as it is in a more rapid inflation. The effects might differ some with respect to time, but not in

ultimate degree. In fact, a creeping inflation can be regarded as even more insidious and dangerous, tending to lull people into inaction and complacency until the rude awakening comes. For once inflation is permitted to go on and on and eventually to get out of hand, harder and more painful measures are required than an ounce of prevention in the earlier stages.

The plain fact of the matter is that inflation is the enemy of growth. That is the lesson of all history, and is apparent in our own economic annals as well as in the records of other countries. Because of this, therefore, stabilization of the dollar's buying power has become an overriding national need.

Growth Objectives

America must grow; we must strive to increase our long-term rate of expansion of about 3 percent a year. Vigorous and sustainable growth is essential to meet our national as well as individual needs. It is necessary for the maintenance of our defense posture in the cold war, to provide employment opportunities and higher living standards for our expanding population, and to meet the challenge of an increasingly competitive world, not only from the communist powers but from Western Europe and the Far East as well. Their growth has been exceeding ours, and threatens to continue to do so unless we bestir ourselves.

These growth objectives have guided us to a significant degree in the past. They are our basic objectives for the future. And reasonable stability in the purchasing power of the dollar is of paramount importance if we are to attain our goals. The accepted yardsticks of growth and their implied benefits lose much of their meaning if they largely reflect inflation expressed in persistently rising living costs and prices in general, with the inevitable social injustices and maladjustments which inflation breeds. Growth of this type is deeply tinged with illusion.

We have had our experience with growth like this in the past two decades, the period in which the dollar has lost more than half of its buying power. The American economy has grown, it is true, but not nearly as much as most of the accepted yardsticks and measurements would indicate, or the times call for. It is like looking at our performance through a magnifying glass, distorting and blowing up what has taken place out of proportion to the realities.

Inflation at Work

A widely-known and respected observer has effectively summed up the ways in which inflation is the enemy of growth, particularly when there is public expectation that the purchasing power of money will continue to decline. He is Winfield W. Riefler, who recently retired after long service as Assistant to the Chairman of the Federal Reserve Board. In an address before the Stanford Business Conference, he declared inflation impairs growth in these ways:

- It increases instability; high levels of activity cannot be sustained for long when inflation is expected to prevail.
- It fosters the misallocation of capital and impairs the quality

of the managerial and investment decisions on which growth is based.

- It distorts the savings-investment process and encourages over-speculation.

- It undermines the country's position in international trade.

The House that Thrift Built

As one who has spent his entire career in life insurance, I am naturally vitally interested in savings and thrift, emphasized in the third point of the summary. But over and beyond my personal views and reactions is the fundamental fact that ours is a high-investment economy; and over the years a driving force of our growth has been the savings of the people channeled into capital investment and into the nation's credit stream by the thrift institutions including the life insurance companies. America is the house that thrift built.

The people's savings and their investment have been translated into new plant and equipment to create more job opportunities and more and better products for the public. These savings have also been a major source of needed social capital to provide the new schools, roads and community facilities required to meet the needs of a growing population. Money for these purposes does not come from speculative activities, nor can it be supplied by equity investment.

Despite the inflationary trend of recent years, the American people have not yet lost confidence on the savings front: ingrained thrift habits are not easily changed or abandoned. But will the American people continue to do so without some assurance that the dollar put aside, whether in life insurance or in other forms of saving, will have about the same purchasing power in the foreseeable future as it has now? That is the basic question. Considering the rising trend of capital and investment needs in recent years, and the likelihood of an even greater increase in the years ahead, encouraging the American people to increase their savings may well prove to be one of the great challenges ahead of us, and perhaps a test of the functioning of our free enterprise system. For if the people through their spending and saving decisions do not provide the needed capital funds voluntarily, other ways will have to be found, ways that may hardly prove palatable to a free people.

Causes and Effects

Inflation is a complex problem, with many roots and causes, some of them going deep into the past. However, some of the principal forces have become obvious, and can be summed up as follows:

- The government cannot continue to live beyond its income, creating credit through deficits as it has done over so much of the past generation, and spending with prodigality and lavishness, without having its effect on our whole fiscal policy and impairing the value of the dollar.

- Wage and production costs cannot increase more than productivity without pushing up prices and living costs and, be-

sides, putting business and industry at an increasingly competitive disadvantage in both domestic and foreign markets.

- Business cannot "administer" prices just because the market will currently sustain them, ignoring long-range competitive and other factors, without affecting the entire price structure and nourishing the inflationary forces in the economy.

- We as individuals should so conduct our personal affairs that we do not lend strength to the underlying inflationary forces. This means buying what we need but using discretion in our credit commitments. It also means the conscious effort to save some of what we earn for tomorrow, both for our own protection and at the same time for the capital needs of the nation.

GOVERNMENT AND INFLATION

A major shortcoming on the anti-inflation front in recent years has been in the federal housekeeping establishment and the record of government finances. Here is one factor which has done so much to keep the inflationary forces in the economy alive and strong, ready to reassert themselves at the first opportunity. And that is why the recent news from Washington is so encouraging, with a balanced federal budget in prospect for the current fiscal year, and a surplus to be used for debt reduction projected for the next fiscal year which begins on July 1.

The turn on the budget front is the more important since there seems to have developed an attitude of mind that we can have everything if it can only be charged to the future, which in essence is what the federal debt does. Every householder knows what would happen if he allowed his own budget to get out of balance and permitted it to go on this way. Somewhere along the line a jolt is inevitable, for time has a way of catching up with improvidence and loose financial practices as it has with everything else.

Government and Public

We must cease looking to our government for all the benefits we would like unless we are also willing to pay for them through increased taxes. Nothing essential need be sacrificed in the process of a more orderly and sensible use of our funds and our resources—neither the requirements of our national defense, nor the normal functions of government, nor the various national and community needs to keep pace with our growing population. There are few budgets at every level of government that are not swollen by some waste and largesse to one and sundry pressure groups. Just a glance at warehouses bulging with excessive and unused agricultural products, and at our overflowing stockpiles of other commodities far beyond conceivable emergency needs, bears out the point.

I have emphasized the role of government since that is one of the roots of the inflation problem which continues to plague us, and can break out again unless we set our house in order.

Fiscal and financial prudence in government and a dollar of reasonably stable buying power are two sides of the same coin. This basic principle applies particularly to the federal government since it collects and spends the bulk of the people's tax money and because its policies, actions and general behavior patterns have such a profound effect on the people and on the course of the economy.

So as we look ahead to the decade of the Sixties and to its promise, let us keep in mind one fundamental fact—that a stable dollar won't come from wishful thinking, or happen on its own. It can come only from concerted action of all of us, as well as government, business and labor. And in a democracy such as ours, in the final analysis it is the choice of the people that counts most and that determines our course.

The Possible Future

America has no Past, but she has a Future. The possible Future of this country is as exciting to the imagination as the vague and fading Past of other lands. We are now but in our first epoch, as what exists, what has been done, seems, as it were, but the fragments of the Future. A century is but a short time in the life of a nation. When another century shall have elapsed, America may very possibly be a state compact and yet confederated, numbering 300 millions of freemen, occupying a region of 3 millions of square miles, with cities of 4 or 5 millions of population, with a commerce external and internal such as the world never imagined.

J. L. Motley, "Polity of the Puritans," *North American Review*, October 1849, pp. 495 *et seq.*, abridged.

JAMES DON EDWARDS

Distribution Costs and Marketing Decisions

An examination of the ultimate goal of the cost accountant's function in market programming

It has been estimated that distribution costs account for about fifty-one percent of the cost of the consumer dollar while production costs comprise the other forty-nine percent. This does not mean that every firm incurs its total costs in this ratio. Each individual firm is only a single link in the chain which extends from the producer to the consumer. The manufacturing firm may incur a much greater proportion of production costs, but there remains the task, with the concomitant costs, of distribution.[1] This task must be carried out by someone.

In spite of the relative importance of distribution costs, most cost accountants concede that accounting for distribution has not been developed to as great an extent as production cost accounting. Yet it is recognized that this field is one in which economy through cost control is badly needed, for it is the basis for programming of market action.[2] Few manufacturers know exactly how much it costs to sell a particular product to a particular type of customer in a specific location. And the number of producers who know how much it *should* cost to make a similarly particularized sale is even smaller. Nevertheless, such information is essential to good control of company costs, and the greatest possible cost saving to an individual firm may be made in this area in which most firms lack adequate knowledge.[3]

The explanation of this situation is probably twofold. Historically, the need for detailed distribution cost accounting is a comparatively recent one. It arises from the increasing importance of distribution occasioned by concentration of production with expansion of markets and from the greater need for efficient distribution due to increased competition in distributive activity. This will be espe-

cially important in the future because the second type of factor accounting for the slower rate of development of distribution cost accounting is a function of the inherent nature of distribution as contrasted with production.

Production of similar products by different firms involves very similar methods in many cases. In contrast, distribution of such products may be performed efficiently in a number of different manners. Distribution methods also are generally much more flexible than are production methods. A large outlay for productive facilities of a specific type usually ties the firm to a certain narrow range of production alternatives for a considerable period. Distribution methods are normally readjusted by shifting from one combination to another as a continuing process. Another point of difference lies in the relative importance of psychological factors. Production is much more subject to mechanical control than is the reaction of a customer to a salesman's efforts. All these factors point to the lack of standardization of distribution activities. Without some degree of standardization, performance can only be measured by highly subjective evaluations.[4]

Still another difficulty is that of securing basic information. There are no timekeepers or inspectors on hand when a salesman contacts a prospective customer. This is still further complicated by the fact that the marketing mix includes not only personal selling, but advertising and sales-promotion as well. These, in turn, are complicated by the fact that they tend to have residual benefits. For instance, a shoe advertisement run by a retail store not only generates sales immediately, but still may be influencing shoe sales months later when viewers or listeners decide they need shoes. Even when the basic cost information is available, the job of interpretation is extremely difficult. Distribution costs, to a much greater degree than production costs, contain many joint and indirect items which must be assigned to specific results. Indirect costs are troublesome in production accounting; they are even more so in distribution.[5] But the need for adequate distribution cost accounting is so great that these difficulties must be overcome, as many of the problems of production cost accounting have been.

DISTRIBUTION COSTS

Distribution costs have been defined as all costs necessary to get the order from the customer, deliver the goods, account for them and collect the account.[6] This is a reasonably broad definition but not the broadest possible, because in essence marketing begins with the determination of increasing wants and the delineation of market opportunities. It is certainly easy to argue that product design is a marketing function and its costs marketing costs. In one sense, all justifiable costs are distribution costs. Theoretically, the objective of the firm is to maximize profits. This can only be done through sales at a price greater than cost. If, then, the distribution of its product at an advantageous price is the primary objective of the firm, all activity should be directed toward that objective and all costs incurred may be viewed as contributing to the distributive process. On the other hand, it could be argued at least equally well that all justifiable costs are production

costs. This argument would contain the implicit shift of meaning of production from production of goods to production of utility as measured by revenue.

Types of Utility

The economist usually recognizes four types of utility; form, place, time, and possession. Production, as commonly defined, involves only the creation of form utility. Distribution, in the usual sense, refers to the providing of time, place, possession and utility. At any rate, such functions as sales promotion, shipping, and collecting are as productive of revenue as is the fabricating process, since all are essential to profitable operations. But accounting classification or division is based in general on responsibility. In most manufacturing concerns, the management organization is divided into the three broad functions of production, distribution and finance. It is always difficult to say which function is the major one. Since all three are essential in some degree, any attempt to rank them resolves into a priority question like that of the chicken and the egg. This situation is becoming more complex today because of the increasing tendency to specialize administrative functions.

In addition to contributing toward marketing efficiency, the use of distribution cost accounting makes it legally feasible to charge different prices to different types of customers, thus passing on to customers the advantages of buying in those quantities or by those methods which result in saving to the seller. Without adequate distribution cost accounting records, the seller may run afoul of the Robinson-Patman Act if he engages in differential pricing when selling to different customer types.

Stages of Cost Handling

The cost accountant must handle company costs through three major stages. He records costs as they are incurred, traces costs in terms of internal activity, and assigns costs to periodic revenue.[7] It is in the second and third stages of this sequence that the treatment of production and distribution costs differs. The tracing of costs within the firm must be done on the basis of some type of cost-unit. For production costs, the unit is usually a specific quantity of the product, as a single automobile or a ton of steel. For distribution costs the unit is not so easily chosen.[8] Only a few business costs are incurred on a clear-cut unit of product basis. Some material, labor, packaging and delivery costs can be related directly to the units of product to which they apply. Other costs are incurred by the enterprise as a whole as a necessity of being in business. These "bread-upon-the-water" costs are not clearly identified with units of product sold. The problem of separating costs jointly incurred for the sale of several types of product and of separating results which jointly stem from one such cost thus arises. This is the crux of the distribution cost challenge.[9]

Sorting Distribution Costs

One method of sorting distribution costs is based on the function for which the costs are incurred. The entire marketing effort is divided into such component functions as direct selling, advertising, warehousing,

transportation, credit and finance, etc. Each of these functions is then broken down into still further divisions until many costs can be segregated directly at incurrence. Costs which cannot be apportioned directly must then be spread on the basis which is assumed to reflect most clearly the benefit derived from them by the various functions.[10] Classification of costs by functions does not, in itself, provide a measure of efficiency nor exert control over costs. However, it is a useful first step in that direction. The comparison of actual costs incurred to perform a function with the costs which should have been required does provide such a measure. Comparison is facilitated when costs are classified by function rather than simply by the nature of the expense, such as rent, wages, etc.[11] But the functional method is a broad one. Its utility depends upon the complexity of the process of distribution required. If many products are involved and the marketing effort is great, the functional method of analysis may not be sufficiently specific to provide adequate control.

A Further Breakdown

To provide the more specific information needed for effective cost control, distribution costs can be broken down into still finer classifications. The combination of direct and indirect allocation again is used to divide functionalized costs according to any of a number of unit bases. Some of these bases are the commodity sold, the type of customer, the channel of distribution, and the territorial or organizational divisions. This type of classification provides a much closer measure of efficiency and technique of control. For example, the actual cost of a specific channel of distribution in selling a given quantity of Product A to small customers in Territory 2 is much more significant for purposes of control than is the total cost of distribution. The methods of indirect allocation used to spread the functionalized costs to these unit-bases are highly important. They will vary according to the particular cost under consideration and the unit-base to which applied. But the utility of the resulting information is a function of their validity in managerial decision making and pricing. The problem is not a simple one, and, as with indirect production costs, it is probably most satisfactorily solved when attacked on an individual-firm basis.

DEFENSE OF STANDARDS

When this sort of analysis is correlated with the study of sales potentials and actual sales results, it can reveal misdirected sales effort and costs which are not justified by results. This information is the foundation of distribution cost control, but in and of itself it is not enough. The proper direction of sales effort does not insure the optimum result. Even profitability is not conclusive evidence of efficiency.[12] The efficient firm may be unprofitable while the inefficient may prosper for a time.

Not only what has happened but also what should have happened must be known for the proper measurement of performance. The decision as to what should have happened can be expressed in budget form or through the use of distribution cost standards. The fact that criteria of satisfactory performance are needed is undeniable.

The chief arguments against standard distribution costs hinge on the difficulty of their determination and their questionable validity once determined. These arguments probably can never be resolved in general, but must be decided on the basis of particular cases. Need for a basis of comparison is a strong argument in support of standard distribution costs. Another interesting brief can be made for distribution cost standards based on the use which can be made of them to resolve the cost or expense question connected with distribution expenditures.[13] To determine the gross profit on sales, the cost of goods sold is deducted from total sales. This cost of goods sold figure is supposedly a true cost since it includes not only direct costs but also allocated indirect costs.

Overcoming Conflict in Treatment

In the case of deductions from gross profit to arrive at net profit, it may be held that there is no relation between the amounts deducted and the actual sales. The selling, financial and administrative costs used represent all expenditures of this type made during the period even though it is apparent that some such costs could have had no relation to sales booked during the period. The accountant is likely to rationalize to the effect that actual expenditures alone are reliable as a measure of such costs. At the same time, he will argue forcefully that the cost of sales figure is a true one though it is probably entirely divorced from the actual production expenditures of the period. The use of distribution cost standards to overcome this conflict in treatment can be illustrated by a simplified profit and loss statement. A standard rate of 25¢ per dollar of sales is assumed.

	Usual Method	Using Standard Distribution Cost
Sales	$100,000.00	$100,000.00
Deduct-Cost of Goods Sold	60,000.00	60,000.00
Gross Profit	$ 40,000.00	$ 40,000.00
Deduct-Selling and Administrative Expense (Actual)	35,000.00	
Standard Distribution costs		25,000.00
Net Profit	$ 5,000.00	$ 15,000.00

Obviously, some disposition must be made of the $10,000 difference between actual and standard distribution costs. If this difference represents avoidable error, it should be written off as a business loss. If, when added to the standard cost figure, it presents a more accurate picture of normal distribution expense it should be so treated. But if it represents expenditures made in the ordinary course of operations to stimulate distribution in succeeding periods, it should remain on the books as a deferred item.

The Ultimate Goal

It must be admitted that where distribution costs regularly recur in similar amounts, no great distortion in results is created by handling them as period costs. However, a similar statement could be made with regard to production costs, which would obviate the need for inventory accounting. The period cost concept would not be widely accepted for the reason that the methods of handling indirect production costs are well established on a unit of product basis while a widely ac-

cepted technique for deferring distribution costs has not been devised. Most accountants would agree that if it is possible to determine the period actually benefited by selling effort it is logical to treat distribution costs as prepaid expenses, but the accountant usually feels that the relation to future periods is not sufficiently definite and clear.[14] It should be the task of cost accountants to develop means whereby such relationships can be determined at least as definitely as those connected with production costs. This task can be restated as the elimination of the distinction in treatment between product costs and expenses or period costs. The truly significant relationship is the one existing between justifiable expenditures which produce revenue and the revenue produced. Costs of revenue, rather than costs of goods and cost of being in business, attain the position of prime importance when the artificial barrier of the accounting period is removed. It is the third step in the cost accountant's activity, the matching of costs to revenue, which is the ultimate goal. The first two steps, the recording of costs and tracing of cost conversions within the firm, are only instrumental to it.

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FRED A. SEATON

The Challenge of Helium Conservation

The government's efforts to preserve for the Free World's needs a vital, and limited, natural resource

Promotion of cooperative effort by government and private industry in natural resource conservation and development has been a cornerstone of the resource policies developed by the Eisenhower administration.

This positive teamwork concept requires vigorous cooperation from the federal government and both public and private local agencies. Because we have believed and practiced this, progress in the past six years has been far beyond what the federal government alone could have accomplished.

In the coming months, American business will be given another opportunity to demonstrate the practicality of the teamwork principle in an urgent program that can provide vital support to our national security—a program to conserve effectively one of the most valuable and most rare of our natural resources: helium.

Forty-odd years ago, helium was little more than a laboratory curiosity. Today it is a valuable military, industrial, medical, and basic research tool contributing to the safety and welfare of our citizens everywhere. With new uses constantly being found, consumption has increased to approximately five times the 1950 level. The result is that without immediate large-scale conservation action we estimate that within 25 years the presently known helium-bearing gas fields in the United States will not be capable of supplying our requirements.

The need for effective conservation was studied intensively during 1957 and 1958 by the Department of the Interior, in collaboration with several other federal agencies. In a report issued January 24, 1958, these agencies unanimously recommended a new national program calling for broad-scale action to preserve the shrinking reserves of this essential resource. The

proposed program was endorsed by President Eisenhower and legislation was introduced in the Congress the same year.

To understand the importance of a new helium policy and before examining the contemplated expansion in production capacity, it seems appropriate to review briefly the history of helium, its unique characteristics, the current status of its production, and its uses.

CHARACTERISTICS

Helium was discovered in 1868, less than 100 years ago. First detected in the gaseous atmosphere around the sun, its name is derived from *helios*, the Greek word for the sun. Not until 1895 was it found on earth, and knowledge that helium was to be found in certain natural gases dates only from 1905.

Unique Qualities

Completely inert, helium chemically is an element which is unique in many respects, possessing extreme properties not found in any other substance.

Only hydrogen is lighter in weight, but unlike hydrogen, helium will not burn. It is for this reason that it became indispensable for navy blimps, weather balloons, and the huge high-altitude balloons employed in studying the earth's stratosphere.

Other Advantages

Because it is inert and an excellent conductor of heat and electricity, the rare gas serves as a shield in high quality arc-welding of magnesium, aluminum, copper and stainless steel. These two characteristics, plus a resistance to radioactivity, make it the preferred material for moving heat developed in nuclear reactors to other equipment where the heat is utilized to develop useful power.

It is ideal as a pressurizing medium in some of the larger ballistic missiles because it is light-weight, inert, and capable of remaining a gas when in contact with liquid oxygen. The weight advantage alone becomes a significant factor making possible increased range or payload.

The inert gas is also used for many other purposes. And day by day, new and valuable applications are being discovered. Some of these are important in basic scientific research, while others have resulted in new practical processes for the benefit of mankind.

GOVERNMENT CONCERN

The Department of the Interior, through its Bureau of Mines, has been concerned with the production of helium since 1917—an interest which first developed out of British need for the gas for barrage balloons early in World War I.

With the entry of the United States into the war, the matter of helium supply became one of vital importance to the military forces of this country as well. Arrangements were made by the army and navy to have the Department of the Interior investigate the feasibility of large-scale separation of the resource from natural gas for military and naval aeronautics. To expedite the program, commercial companies whose business involved the separation of gases were invited to participate. Several experimental plants were built, and at the close of

World War I about 200,000 cubic feet of helium had been produced and was available for shipment to Europe.

Research and Production

After the war, this nation's military agencies arranged with the Department of the Interior to investigate more economical methods of separation—a project which resulted in the process that has been used successfully for the past 35 years, with occasional improvements.

Since 1925, the Department's Bureau of Mines has been charged with the responsibility of furnishing helium to the federal agencies and, since 1937, has been authorized to make commercial sales to industry. The Bureau of Mines today is the sole producer of helium in the Free World.

Search for a Rarity

The Department of the Interior has carried on a thorough and continuous survey for helium-bearing natural gases. As a result, we know with a considerable degree of accuracy the areas in the United States where this vital resource is located. The greatest quantity thus far discovered is in the natural gas fields of the Texas and Oklahoma Panhandles and the southwestern portion of Kansas. Natural gas containing helium in concentrations of one percent or more is found in other parts of Kansas, but the fields generally are not large and are scattered. Some of the rare gas also has been found in certain of the natural gases of Colorado, New Mexico, Arizona, and Utah.

Most of the gas fields in California and along the Gulf Coast contain little helium. This is generally true also of the Appalachian area. Helium-bearing natural gas has been found in Canada, but the percentage is low.

No complete survey has been made of natural gases produced outside of the United States, but those gases that have been sampled elsewhere have not shown helium in more than minor amounts. The U.S.S.R. has recently claimed the discovery of some helium-bearing natural gas.

Wastage

It has been estimated that the gas fields in the Texas and Oklahoma Panhandles and the adjoining areas of Kansas contain about 120 billion cubic feet of recoverable helium. While this is about 350 times the present annual consumption in the United States, almost all these fields are producing to supply gas markets without first extracting the helium content.

The result is that, at the present rate of use, about four billion cubic feet of the rare gas is being lost annually in the natural gas consumed as fuel. In other words, the helium supply is being depleted as rapidly as are the natural gas supplies that contain it.

THE CONSERVATION PROGRAM

To put an end to the waste of a critically important natural resource, the Department of the Interior, in 1958, took action to develop a long-term and large-scale conservation program. Unfortunately, however, our plans cannot be put into effect because the Department does not yet have the authority to enter into production or purchase contracts. It is our hope that the Congress will act favorably this year on

the legislation requested two years ago by the Eisenhower administration, so that we may take the steps necessary to conserve more of this essential element.

The proposed conservation program recognizes that the possibility of finding large new sources of helium is remote. It is designed, therefore, to conserve much that is now being lost. We estimate (and I feel our estimates are modest) that some three billion cubic feet per year could be recovered by extraction plants which would remove the critical resource from natural gas now going to fuel markets.

Production

Until last November, total annual production of helium at the four government-operated plants located at Amarillo and Exell in Texas, Shiprock in New Mexico, and Otis in Kansas, was about 340 million cubic feet—an output which failed to keep pace even with the current demand.

In other words, our total production, far from providing a surplus to prepare for the accelerating requirements of the future, often did not meet the many pressing current needs of our expanding military and scientific programs.

On November 17, 1959, our fifth and newest plant, an important new facility at Keyes, Oklahoma, was dedicated, to help solve the increasingly acute supply problem. This sizable new plant is expected to increase production by some 290 million cubic feet per year—almost doubling the previous total. With approximately 600 million cubic feet of production now annually available, we are prepared at least to deal with current demand, and can set aside comparatively small quantities as a safeguard against the future.

New Facilities

The Administration's conservation program deals, however, with the problem of future requirements and supply on a much broader and more comprehensive scale. It proposes the construction, as rapidly as possible, of as many as 11 additional plants. The large amounts of helium removed at these plants would travel through pipelines to the government-owned Cliffside Gas Field near Amarillo, Texas, for underground storage and stockpiling. Our experience clearly demonstrates that such storage methods are both safe and feasible.

The Department of the Interior hopes that private industry will come forward to finance, construct, and operate these plants to produce helium for sale to the federal government—now the consumer, directly or indirectly, of most of the total national yield. Authority to make contractual arrangements for the participation of private enterprise in the conservation program is provided in the Department's legislative proposal, and it is gratifying that several business firms already have indicated an interest in the operation of the proposed new plants. This vital program provides a challenge, I believe, to both government and industry to work together as a team in meeting the growing threat to a truly valuable resource.

Alternatives to Conservation

A natural question arises as to what alternative there might be to this conservation program. So far as we know,

there is none. Helium is not yet in short supply. We have billions of cubic feet of it in our natural gases, but it is slipping through our hands. Previously I pointed out that our major gas fields in Texas, Oklahoma, and Kansas contain about 120 billion cubic feet of recoverable helium. But federal experts estimate that 52 billion cubic feet of this total will be wasted in fuel gas going to market between now and 1985—if nothing is done to conserve it.

When our supply of helium-bearing natural gas is exhausted, we will have to look either to sources outside the United States—and, to date, we know of no such sources—or to the atmosphere. But the air contains only one part helium in 200,000, and technicians estimate that the cost of recovering it from that source would be approximately 1,000 times the present cost.

We do not know what new uses will be found for helium in the future. But we do know that lack of this resource would seriously affect the security of America and of the entire Free World. We know also that it would exclude scientists and engineers in a very complete way from a vast number of scientific and technological developments which could benefit the lives of all.

Many leaders, both in and outside government, are seriously concerned at the consequences of failure to take prompt and effective conservation measures. If we wait, it may be too late. For this reason, it is incumbent upon us to take decisive action now to put a planned, large-scale helium conservation program into operation.

JACK STIEBER

Non-Wage Aspects of Collective Bargaining

Effects on productivity, labor mobility and economic growth

Non-wage aspects of collective bargaining would seem to include all contractual provisions except those pertaining directly to rates of pay. For purposes of this discussion, I have divided the non-wage provisions found in a typical collective bargaining agreement into five broad classifications and indicated the kinds of subjects covered under each classification.[1] This listing is, of course, designed to be illustrative rather than exhaustive.

- *Structural and procedural*: scope and purpose of the agreement, procedures governing the handling of grievances and arbitration, prevention of strikes and lockouts, reopening clauses.
- *Status and rights of the union and management*: union recognition, rights and responsibilities of the parties, union security, union representatives' activity during working hours.
- *Job tenure and job security*: layoffs, promotions, transfers, and the application of seniority.
- *Work schedules, work speeds and production methods*: determination of the standard work-day and work-week, overtime pay, holiday pay, vacation schedules, machine assignments, assembly line speeds, time standards and work quotas under incentive systems, crew size, work methods, introduction of new machinery, working conditions governing health, safety, heating and lighting.
- *Off-the-job security*: pensions, health and welfare plans, supplementary unemployment benefits, severance pay and other clauses which try to ease the workers' lot upon retirement or loss of work for other reasons.

Rather than consider the economic significance of provisions in each of the classifications, I shall address myself directly to the following questions: what are the effects of the non-wage aspects of collective bargaining on productivity? On labor mobility? On economic growth?

IMPACT ON PRODUCTIVITY

The contract provisions which have often been considered as having negative effects on efficiency are those dealing with seniority, production methods, work rules, crew size and others which tend to reduce or limit average output per manhour. The effects of seniority might be considered as indirect while the so-called make-work policies directly affect productivity.

American management generally believes that efficiency of operations would be increased if more regard were given to ability and less to seniority in promotions and layoffs. While, under most contracts, management may promote a junior employee where he has greater ability, supervisors are loath to risk going to arbitration on the issue of seniority vs. ability. This reluctance stems from a belief that arbitrators tend to overemphasize the objective factor of seniority at the expense of the subjective factor of ability; a tendency of arbitrators to put the burden of proof of greater ability on management; and a growing collection of arbitration opinions that a company must be able to prove that a junior man is head and shoulders above the senior man in ability to warrant his promotion, even under a clause which says that seniority will govern in promotions only when ability, merit and capacity are equal. In layoffs, seniority rule — especially under a system of plant-wide seniority — requires management to go through a costly bumping policy and wind up, at a time when efficiency of operations is particularly important, retaining men not on the basis of their relative worth to the enterprise but because of their continuous length of service in the plant. Finally, management decries the lack of incentive for workers to put forth their best efforts in the hope of promotion because of the importance attached to seniority.

Effect of Seniority

While not readily measurable, the impact of strict seniority provisions is undoubtedly in the direction of decreasing efficiency in a particular company. However, it is probably not as adverse to efficiency as depicted by managements because of the growing importance of machine-paced as opposed to man-paced jobs making ability less important, the likelihood on many jobs of finding a high correlation between length of service and ability, and the increase in efficiency which may result from the greater security provided by seniority. There is also some reason to question the competence of management to assess accurately relative ability as between employees to do a given job. This skepticism would appear to be justified by the findings of Professor James Healy of the Harvard Business School, who investigated 58 arbitration awards in which the arbitrator had set aside management's decision to promote a junior man over a senior employee on the basis of superior ability.

Out of 46 replies, the senior employee was found to have proved himself able to do the new job within a short period of time in 29 cases. Furthermore, in 22 of the 29 cases, supervision expressed doubts whether the junior employee originally favored by management would have done any better on the job.[2]

Even if we acknowledge that individual companies might increase their over-all efficiency if not tied down by seniority provisions, this does not mean that the national economy would benefit. This is just another case where the whole does not equal the sum of its parts or (to reverse a more modern aphorism) "What's good for a particular company is not necessarily good for the United States." By laying off older workers and retaining more productive younger men, a company would be improving its own efficiency and profit position at the expense of the economy generally, for such older workers would probably have difficulty finding alternative employment opportunities and if reemployed would undoubtedly be less productive in a new work environment than they were in their former jobs. Viewed in this context, seniority may be regarded as a method of distributing the less productive employees more or less equitably among employers, rather than concentrating them among the lower-paying firms who can probably least afford a further drag on their over-all efficiency.

Before leaving the subject of seniority it is well to point out that continuous length of service is also important in non-union companies. A National Industrial Conference Board study of 110 non-union companies in 1950 found that over 95 percent gave consideration to length of service in layoffs and over 70 percent considered seniority in promotions and rehires.[3] On the other hand, outside the United States, seniority is given much less weight even in unionized companies. Teaching in Great Britain last spring, I found management and union representatives quite surprised at the important role played by seniority in the United States. Management officials particularly found it difficult to understand how the high productivity which they almost unquestionably accept as characteristic of American industry could go hand in hand with this apparent disregard of merit and ability in deciding which employees to promote or to retain in layoffs. The absence of pre-determined rules to follow may serve as a partial explanation for the relative frequency of work stoppages in Great Britain when layoffs do occur.

Restrictive Practices

Make-work policies of unions have been classified into nine categories by Slichter in his *Union Policies and Industrial Management* written twenty years ago. While the emphasis among these categories may have shifted, they still represent a comprehensive grouping of ways in which unions may attempt to increase employment:

1. limiting daily or weekly output;
2. limiting speed of work;
3. controlling quality;
4. requiring time-consuming methods;
5. requiring unnecessary work;
6. regulating crew size or requiring unnecessary men;

7. requiring that work be done by a particular skilled trade;
8. prohibiting employers or foremen from doing production work;
9. retarding or prohibiting use of machines or labor-saving devices.[4]

It is unnecessary to discuss in detail the above listed restrictive practices. They all share in common the objective of requiring a greater input of man-hours per unit of output than would be required in their absence. In order to place them in proper perspective, I should like to make the following points regarding restrictive practices.

- Make-work practices are not an invention of trade unions. They are found among unorganized as well as organized workers, in offices as well as in plants; among professionals as well as among less educated groups; and even among the executives of the same companies that inveigh loudly against make-work practices in their plants. Who has not heard of Parkinson's law which leads to empire building even while actual productive work is decreasing? Or what knowledgeable and honest teacher would deny that part (not all, but part) of the opposition of teachers to using TV to help solve the teacher shortage may be explained by the same "lump of labor" theory that professors of economics are so busily disproving in their classrooms?[5] Unions may be blamed for formalizing and enforcing restrictive practices but not for inventing them.

- Economics textbooks tell us that make-work rules and policies are more prevalent among craft unions than among unions organized along industrial lines. Presumably this is so because skilled workers have more to fear from de-skilling technological changes and loss of work to other crafts or to lesser-skilled workers. But today we find that it is in the industries organized by large industrial unions that the greatest battles are being fought over so-called restrictive practices: steel, meatpacking (in two companies), oil refining, nonferrous metal mining, glass. How should we account for this sudden interest of employers in mass production industries in practices which have been prevalent for years in their industries without exciting much active opposition?

Employers explain it in terms of increased competition, return of a buyers' market, and lower profit margins. Perhaps this is so, but it is only one side of the equation. It is significant that the drive against make-work rules has come to the fore shortly after the most serious recession of the postwar years. Many of the workers who are now insisting on strict adherence to "local working conditions," "working rules," less productive methods, etc., were unemployed or on a short work-week in 1958. Many of their friends and co-workers are still unemployed despite soaring production indexes and improved profits. They do not have to hark back to the thirties (although many of them can and do) to rationalize actions to "make the job last" as long as possible.

- Behind make-work rules, restrictive practices and opposition to technological change is the fear of unemployment and economic insecurity. Workers and unions may agree that limiting output is bad for the company, for the economy and even for

their own long-run employment opportunities. These are things that they have been *told* and that intellectually make sense. But the individual *knows*, often from personal experience, that changing technology and high productivity may mean less work for him next week, next month or next year. Understanding the reasons behind featherbedding and make-work rules should give us a clue as to how to deal with them—in short, like any good doctor we should try to treat the underlying cause of the illness, not the symptom.

Recent agreements in meatpacking and in the Pacific Coast longshore industry seem to have recognized this distinction between symptoms and underlying causes of workers' anxieties over automation. Originally suggested by Armour & Co., contracts have been signed between the two unions in the meatpacking industry, the United Packinghouse Workers and the Amalgamated Meat Cutters and Butcher Workmen, and eight companies setting up "automation funds" to be financed by the companies. In Armour the company will contribute one cent for every hundred-weight of meat products shipped up to a maximum of $500,000. The fund is to be used to "cushion whatever unemployment may arise through the introduction of automation."[6] On the West Coast the Pacific Maritime Association and the International Longshoremen's and Warehousemen's Union have set up a mechanization fund under which dock workers will receive a share of the savings from the introduction of labor-saving devices. In return the union has promised not to oppose the introduction of new machinery.[7]

Other companies and industries interested in reducing union opposition to automation and changing restrictive contractual provisions might well consider this approach rather than attempting to achieve their objectives by persuading unions and workers that make-work policies are "bad" for the economy and "wrong" as a matter of principle.

- It is ironic that restrictive work practices should be such an important issue in the United States of all countries. During the postwar years, some 66 British productivity teams, made up of management technicians and operatives from various industries, have visited the United States to learn our secrets of increased output and productivity. Graham Hutton summarized the reports prepared by these teams in a book entitled *We Too Can Prosper*:

> Team after team noted the interdependence in American industry of the "sense of *camaraderie* and freedom of expression based on mutual respect," the readiness to change working assignments and conditions, the willingness of unions to conform to new methods or apply new machinery (with hard bargaining for due reward!), and the all-pervading belief in the need to raise productivity.[8]

On the other hand, J. A. Livingston, a journalist who writes on economic subjects, compares American workers' attitudes towards productivity unfavorably with those of workers in the Soviet Union on the basis of a report by Professor Emily Brown of Vassar.[9] I understand from other studies of the Soviet system of production that they too have their problems of achieving maximum effort and productivity.[10] But if Soviet workers are more amenable to technological changes and more cooperative in

efforts to maximize production, I suggest that the relative unemployment rates in the two countries may be part of the explanation. In this regard, it is significant to note that American companies using the union-management cooperation system known as the Scanlon Plan, which rules out layoffs resulting from increased productivity, have been highly successful.

• Finally, so-called make-work rules, featherbedding and other restrictive practices may, on investigation, turn out to have a sound basis. Like so many other issues which seem to be quite clear on the surface, there are usually two sides to the argument over specific make-work practices.[11] Slichter's admonition of 1941 still holds true today:

> It is not always easy to determine when a union is "making work." There are some clear cases, such as those in which the union requires that the work be done twice. But the mere fact that the union limits the output of men, or controls the quality of the work (with effects upon output), regulates the size of crew or the number of machines per man, or prohibits the use of labor-saving devices does not in itself mean that the union is "making work." In such cases it is necessary to apply a rule of reason and to determine whether the limits are unreasonable. Opinions as to what is reasonable are bound to differ, but failure to apply a rule of reason would be to accept the employers' requirements, no matter how harsh and extreme, as the proper standard.[12]

Balance of Factors

As in the case of seniority, it is probable that certain contractual provisions pertaining to work speeds, methods and other limitations on production have an adverse effect on productivity. But there are balancing factors which must be considered before closing the books on this subject. On the credit side, we must assess the positive effect on productivity of the increased security given workers by such contract provisions as seniority, pensions, SUB, severance pay, the grievance procedure, and negotiated funds to study and decrease the deleterious effects of automation. Like their negative counterparts, the monetary value of these clauses cannot be estimated, but there is little question that high worker morale, increased security and increased productivity go together.[13]

Even more important are the pressures that increased production costs exert on management to increase efficiency. In addition to substantial wage increases during the postwar years, costs of other contractual benefits have also risen. The Secretary of Labor, in his background report on the steel industry, stated that fringe benefits in manufacturing came to 29 percent of straight-time average hourly earnings. The cost of fringe benefits is probably more directly attributable to unions than wage increases, which are more responsive to labor market pressures. Unions must take much of the responsibility for the increasing cost of fringe benefits and are entitled to some of the credit for measures taken by management to raise productivity in order to meet added costs of production.

It is useless to try to assess the net effect of unions on productivity, faced as we are with opposing influences neither of which is measurable. This, however, should not deter efforts to minimize and, if possible, eliminate those union practices and policies which tend to decrease productivity, while at the same time retaining the positive effects of other provisions

which operate in the opposite direction.

IMPACT ON LABOR MOBILITY

In a free competitive economy we depend on the mobility of capital and labor to achieve the optimum allocation of those resources among producing units. It has been claimed that contractual provisions which tie workers more closely to their jobs and companies decrease labor mobility and thus hinder economic growth. The provisions most often cited in this connection are those dealing with seniority, pensions, supplementary unemployment benefits and others which relate benefits to length of service.

The Joint Economic Committee last March heard from Stanley Lebergott regarding the long-term factors limiting labor mobility, including such revered symbols of our culture and our time as the American home, motherhood, education, national defense, individual security, enlightened personnel policies, and government efforts to maintain the family farm. Also mentioned was the end of large-scale immigration. If unions, through collective bargaining, have added to these immobilizing factors, they are in very good company. However, it is not at all clear that the non-wage aspects of collective bargaining have had any significant effects on the mobility of labor.

Ten years ago when negotiated pension plans were proposed and then won by unions in several major industries, they were deplored by management, government and academic economists as an undesirable development because they would chain workers to their employers and inhibit labor mobility. Even labor leaders and economists did not seriously dispute this, though they justified their demands on the ground that private plans seemed the only way to increase the miserable benefits then being paid under social security.

In the last few years the pendulum seems to have swung in the other direction. Recent studies point out that labor turnover or mobility (depending on whether you prefer the "bad" word or the "good" one) has always been concentrated among younger workers — a fact which should have been apparent even in 1949. Workers who stand to lose the most from changing jobs (in terms of seniority and accrued pensions) are in higher age brackets where turnover has always been relatively low.

Arthur Ross, after an intensive examination of quit rates over the last 45 years, concluded that "little evidence can be found for the proposition that labor resources have become immobilized and a new industrial feudalism has been created because men can no longer afford to quit their jobs."[14] In another study, Robert Tilove found that though private pension plans *tend* to restrain mobility, other influences such as those mentioned earlier are much more important. Tilove even suggests that, in the future, pension plans may contribute to the increase of mobility by freeing workers from physically demanding jobs at an early enough age to move to lighter jobs.[15]

IMPACT ON ECONOMIC GROWTH

Economic growth is the result of a combination of productivity gains and increases in the quantities of labor, capital and other inputs used in pro-

duction. Productivity increases have been estimated to account for about half of the rise in total real output of the American economy since the turn of the century.[16] The non-wage contractual provisions discussed earlier would appear to have had only minor effects on productivity and mobility of labor, the avenues through which they might have had some influence on economic growth. Much more important to economic growth, both in the past and in the future, are such factors as changing technology, training, education and size of the labor force, the rate of investment, research and development, managerial skill, and hours of work.

The Work Week

The last-named factor — hours of work — is the avenue through which unions have probably had the greatest influence on economic growth in the past. It may also be the most important factor through which unions are likely to influence economic growth in the future, though with somewhat different results.

Since 1890 we have seen a reduction in the average work-week in manufacturing from about 60 to 40 hours. Unions have been a major force in achieving this change, both through collective bargaining and legislation. Despite this reduction of one-third in the average work-week, total output has increased substantially. It has been estimated that productivity increases during the last 50 years have been shared in a 60-40 ratio as between income and leisure.[17]

Today unions tend to favor a further reduction in the work-week. The results of such a reduction, should it occur, may not be as favorable for economic growth as in the past. Historically, the shorter work-week has gone a long way towards paying for itself by speeding up the average tempo of work, and by reducing accidents, wastage and absenteeism. Such favorable effects on output per manhour are less likely to result from future reductions in hours worked per week. While one cannot say with certainty what is the "maximum-output week" under a given technology — and it will vary among industries and occupations — evidence suggests that it is probably not less than 40 hours per week in most industries.[18] This is not to say that a reduction in the work-week is undesirable. Productivity increases will continue to occur as a result of factors other than the number of hours worked per week. They may even be accelerated by increasing automation. The benefits of these increases in output per manhour may be taken either in the form of increased real output or increased leisure, or, as in the past, in some compromise between these two. The shorter work-week can be had — but only with some sacrifice of additional income.

If unions and their members are prepared to choose more leisure over more income, the shorter work-week is a logical policy to follow. If, however, the shorter work-week is designed to serve as a remedy for unemployment, there are other ways of achieving this goal which are more consistent with the objective of a growing national economy.

Notes

1. With some modification these classifications are taken from Lloyd G. Reynolds, *Labor Economics and Labor Relations*, 3rd edition. Englewood Cliffs: Prentice-Hall, 1959.

2. James J. Healy, "The Factor of Ability in Labor Relations," Chapter III in *Arbitration Today*, edited by Jean T. McKelvey. Washington: Bureau of National Affairs, 1955.

3. *Seniority Practices in Non-Unionized Companies*, National Industrial Conference Board, Studies in Personnel Policy, No. 110, 1950.

4. Sumner H. Slichter, *Union Policies and Industrial Management*, Washington: The Brookings Institution, 1941. Chapter VI.

5. See for example the article, "Teachers and TV," *Wall Street Journal*, Sept. 9, 1959.

6. *Business Week*, Sept. 19, 1959, pp. 56-58.

7. *Business Week*, Sept. 5, 1959, p. 100.

8. Graham Hutton, *We Too Can Prosper*, New York: The Macmillan Co., 1953, pp. 145-46.

9. *The State Journal*, Lansing, Michigan, Sept. 21, 1959.

10. See for example Joseph S. Berliner, *Factory and Manager in the USSR*, Cambridge: Harvard University Press, 1957.

11. See for example Morris A. Horowitz, "The Make-Work Effects of the Railroad's Constructive Allowance Payments," *Labor Law Journal*, May, 1955, pp. 331-334.

12. Slichter, *op. cit.*, pp. 165-166.

13. I am aware of studies with contrary findings. For a complete list of citations pro and con see Harold L. Wilensky, "Human Relations in the Workplace: An Appraisal of Some Recent Research," Chapter III in *Research in Industrial Human Relations*, edited by Conrad M. Arensberg, et al., New York: Harper & Bros., 1957.

14. Arthur M. Ross, "Do We Have an Industrial Feudalism?", *American Economic Review*, December, 1958, pp. 903-920.

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16. John W. Kendrick, "Productivity Trends: Capital and Labor," *Review of Economics and Statistics*, August, 1956, pp. 248-257.

17. See Clark Kerr, "The Prospect for Wages and Hours," Chapter 6 in *U.S. Industrial Relations: The Next Twenty Years*, edited by Jack Steiber, East Lansing: Michigan State University Press, 1958.

18. P. Sargent Florence, *The Economics of Fatigue and Rest*, New York: Henry Holt and Company, 1924; *The Health and Efficiency of Munitions Workers*, London: Oxford University Press, 1940; BLS, *Hours of Work and Output*, Bulletin No. 917, 1948.

HORACE B. POWELL

Foundations Open New Frontiers

Maximum social return: the only valid criterion of the utility of philanthropic programs

Allegedly young Benjamin Franklin entered Philadelphia carrying his own provisions—a "long roll" under each arm while he munched a third. Be that as it may, Franklin matured to become a man of great versatility and of tremendous good will, parlaying his modest assets into monumental works, wealth, fame, and even a little gossip. The achievements, the fame, and the gossip lingered after the sage's death, but so did a considerable quantity of his wealth and good will. Franklin's latter two assets made him America's first philanthropist, for his will provided:

> Having myself been . . . assisted to set up my business . . . by a kind loan of money . . . which was the foundation of my fortune, and of all the utility in life that may be ascribed to me, I wish to be useful even after my death, if possible, informing and advancing other young men that may be serviceable to their country.

Franklin left £1,000 to the town of Boston and an equal amount to the city of Philadelphia to be lent at interest to young, married artificers of good character. Estimating that each of these sums would have increased to £131,000 after 100 years, Franklin requested the expenditure at that time of £100,000 on public works "of useful, convenient and agreeable character," and the accumulation of the remainder for another century, when the whole was to be distributed. Eventually the remainder went to endow the Franklin Institute in Philadelphia, founded "for the promotion of science and the useful arts." The W. K. Kellogg Foundation of Michigan is currently assisting the Franklin Institute to develop a projection magnifier for the partially sighted and a sensitive cane for the blind.

Philanthropy Yesterday and Today

Antedating Franklin as a philanthropist were a few men in other

countries and other eras. An unidentified giver is chronicled in the ancient Egyptian *Book of the Dead* where it is related: "He gave bread to the hungry; water to the thirsty; raiment to the naked; and he gave a boat to a man who had none."

The word *philanthropy* derives from two Greek words meaning *love of mankind,* and the concept is an ancient one. There have been in all ages some persons who have illustrated the existent, if inconsistent, impulse of generosity from one human being toward another. However, the philanthropist has been largely a phenomenon of the twentieth century—and, with the exception of a few individuals in the United Kingdom, he has been a subspecies of *homo sapiens* principally to be found in the United States. During the first quarter of this century, these persons were usually millionaires inspired by Andrew Carnegie's Gospel of Wealth which challenged them to be "a trustee for the poor, entrusted for a season with a great part of the increased wealth of the community, but administering it for the community."

Such personal philanthropy was usually more spontaneous than organized and sometimes more capricious than wise. The trend in the last several decades has been toward the formation of foundations which provide a more systematic pattern for giving and are further defined by F. Emerson Andrews, Director of the Foundation Library Center in New York, as:

> . . . usually a non-governmental, nonprofit organization having a principal fund, managed by trustees or directors, and established to maintain or aid social, educational, charitable, religious or other activities serving the common welfare.

Eight Thousand in U. S.

There are more than 8,000 general research, special purpose, and family foundations in the United States today, with the larger 150 of these organizations holding more than half the assets and annually accounting for approximately three-fourths of all foundation giving. The total assets of U.S. foundations are estimated at $10 billion but fluctuate in value because of heavy holdings of common stock in the portfolios of many of the organizations. Some of the larger foundations and their approximate assets are:

Ford Foundation	$2,224,000,000
Rockefeller Foundation	648,000,000
Duke Endowment	414,000,000
John A. Hartford Foundation	414,000,000
Carnegie Corporation	253,000,000
W. K. Kellogg Foundation	215,000,000
Alfred P. Sloan Foundation	176,000,000
Lilly Endowment	157,000,000
Commonwealth Fund	117,000,000
Danforth Foundation	110,000,000
Kresge Foundation	95,000,000
Carnegie Institute of Washington	81,000,000

Within the state of Michigan alone there are nearly 250 foundations of varying size and having total assets of perhaps $700,000,000. (Not included in the Michigan total and listing is the huge Ford Foundation which, while incorporated in Michigan, maintains its headquarters in New York.) Among the larger of these organizations in the state are W. K. Kellogg Foundation, Battle Creek; Kresge Foundation, Detroit; Ford Motor Company Fund, Dearborn; Charles Stewart Mott Foundation, Flint; McGregor Fund, Detroit; Josephine E. Gordon Foundation, Detroit; Cranbrook Foundation, Bloomfield Hills; Herbert H. and Grace A. Dow Foundation, Midland;

Grand Rapids Foundation, Grand Rapids; and Elsa U. Pardee Foundation, Midland. Within recent years, a time stipulation caused the termination of another foundation of great scope and significance—The Children's Fund of Michigan, founded by the late Senator James Couzens, which functioned a quarter of a century for the welfare of the children of Michigan.

A FOUNDATION'S REASON-TO-BE

In 1958, the gifts of American foundations to assist programs over the world totaled more than $505 million. The total giving for 1959, not yet compiled, undoubtedly will be considerably greater. Such philanthropy, with an impact to one degree or another upon the people and living conditions in communities of every continent, illustrates the *social usefulness* of foundations, their reason-to-be. The foundation's role in society properly is that of a risk-taker on man's cultural, intellectual, scientific, and humanitarian frontiers; its gifts are catalytic agents to inspire and aid communities, institutions, and agencies to solve their problems. Foundation moneys—sometimes called seed money, venture capital, or risk capital—have literally opened new vistas for the development of man and his communities.

Sometimes the programs subsidized by foundations create marked changes in the life of a community, a state, a region. Sometimes there is a salutary effect upon the evolution of health and educational ideas which affect several continents, if not the world. Foundations are able to assume the financial risks of these pioneer enterprises which, because of their experimental character, might prove an unwarranted burden upon the regular administrative budgets of sponsoring institutions or agencies. And the discoveries resulting from foundation grants to the sciences, the humanities, the arts, and toward community improvement, witness that the considered and imaginative investment of relatively small sums may accomplish great purposes.

A Wide Scope of Interest

If foundations are to be concerned primarily with pioneering and experimental efforts, then their policies and scope of interests must be extremely flexible. It is granted that most persons and institutions of good will continue to seek new approaches to what are actually old problems of human welfare. Nevertheless, the frame of reference for these problems, is always shifting, and foundations, to fulfill their role of servitors to society, must be amenable to change. As a case in point, until 1933 and the Great Depression, the relief and betterment of social conditions and personal needs—sometimes called "social welfare" or "charity"—were chiefly tasks for private philanthropy. However, since the depression the federal government has given sums to social welfare that completely overshadow any private giving, and foundations have largely left this area to the government in favor of aid to research for the creation of new knowledge or to facilitate the wide communication and application of existing knowledge.

Among the 8,000 foundations, there are those concerned with almost every aspect of human culture and community life, but generally speaking there

is a trend toward the limitations of interest to selected subject areas and sometimes to definite geographic regions. Much of the financial support of the larger foundations goes to state, regional, national, and international causes related to education, international understanding, research in the health fields, the social sciences, the physical sciences, the humanities, and public affairs. Family and small foundations are more likely to give support to health, religious, and educational causes in local areas. (Where grants from a larger foundation are centered in one community, this usually is for pilot or experimental and demonstration purposes, with the program designed eventually to be perfected and extended to other communities.)

More specifically, grants in medicine might range from funds to establish an international institute of nutrition (or to set up a center for research of some wide-ranging disease) to the more modest project of a fellowship to enable a foreign physician to study for a year or so in the United States. Aids in education could run the gamut from a national program of preservice and inservice education for school administrators to a gift that would enable the local high school to add a swimming pool to its modest, tax-supported building plans. Foundation funds might enable a town or group of towns to undertake a survey of community facilities and projected needs for the growing number of Senior Citizens. A five-year subsidy could play an important part in developing practical nurse schools to educate auxiliaries in an effort to mitigate the current nursing shortage. Or, in the field of hospitals, foundation funds might be used to set up an experimental Intensive Patient Care Unit, which matches the facilities and services provided by the hospital to the needs of the patient in his particular stage of illness and is a revolutionary idea that should have a far-reaching impact upon the design of hospitals and the improvement of the care of hospitalized persons throughout the nation.

By-Products of Philanthropy

Often there are important by-products from a foundation-assisted program that are as important as the central goal itself. Foundation giving presents the opportunity to show some of the benefits from benevolent capitalism, for most philanthropic organizations, of course, derive their funds directly or indirectly from industrial profits. For example, the W. K. Kellogg Foundation (this foundation is mentioned several times within the article because of the writer's affiliation with it and the fact that "one writes best about what one knows") holds more than 51 percent of the common stock of the Kellogg Company, with the Foundation's use of the dividends meaning that more than half the declared annual dividends of this particular corporation go toward the general welfare of peoples on four continents.

Another by-product of philanthropy is the creation of a friendlier feeling among the nationals of various countries. For instance, fellowships granted by a number of foundations to enable educators, foreign physicians, dentists, hospital administrators, and nurses to study in United States institutions "sow seeds of international good-will," according to experts on foreign affairs.

Fellows so aided are from the professions; they are of the leadership echelons of their respective nations, and through their sojourns in the United States they take home gratitude and an understanding of American aims which are communicated to the people. There are similar reactions to foreign-based programs which are aided. A private agency such as a foundation sometimes can move more expeditiously to develop relations with foreign governments and institutions than can the more complex federal government. Following the issuance of a recent annual report, the Kellogg Foundation received an appreciative letter from the Irish segment of an agricultural-educational program that affects rural portions of the United Kingdom:

> Your year's expenditure of over five million dollars without distinction of religion, race or country is something of which too few of my fellow Irishmen are aware. Permanent gratitude is due for your generosity in providing 1½ million dollars for Europe alone. This high example of true charity is another action typical of the help given by the United States to its less fortunate neighbors.
>
> But I trust you will not misunderstand me when I say, additionally, that as an ordinary Irish farmer, I can more immediately appreciate the good your gift to the Young Farmers' Clubs Junior Section, Macra na Tuaithe, is doing. Under our new educational director, made possible by your gifts, our organization is making enormous strides. Its greatest value is that it caters for a section of our youth which has previously been almost ignored, and the next generation will prove its worth. I hope, Sir, that it will not be long until you are able to see for yourself some of the gatherings of these juniors with their happy faces and samples of their projects and handiwork. I feel you will not be disappointed.
>
> On April 30 next the President of Ireland will open our new office and the work of your Foundation will be more officially recognized. Yet I wished also that you should be informed privately of our gratitude. Certainly the New World is being called in to redress the balance of the Old.

TYPES OF FOUNDATIONS

As might be anticipated among a a total of more than 8,000, there are several classifications into which foundations fall. The Foundation Library Center in New York, with the most complete records available upon philanthropic organizations, uses these classifications: General Purpose Foundations, Special Purpose Foundations, Family or Personal Foundations, Company Sponsored Foundations, Community Foundations, Government Foundations (such as The National Science Foundation which appropriates tax money for research), Industry-Wide Foundations, and Community Trusts.

Most of the categories above have titles which explain their goals and functions. However, it perhaps should be further explained that there are two other important ways of categorizing foundations — *Operating* versus *Grant-Making* and *Research* versus *Application*.

Operating

An operating foundation, with a staff of field personnel, actually carries out a program, doing the planning, the follow-through, and the work necessary to achieve a desired goal. During its first eleven years the W. K. Kellogg Foundation was an operating organization. Using more than $8 million and a staff of educators and librarians, physicians, dentists, public health personnel, sanitary engineers, and nurses, the Foundation assisted seven counties in southwestern Michigan to establish health departments, to improve health services, and to accomplish a complete reorganization of their public schools. After 1941, however, when aid to this

Michigan Community Health Project was completed, the Kellogg Foundation abandoned direct operation of any programs and now confines its assistance to grant-making: furnishing the needed money only, with the direction and all operations the exclusive province of the recipients of the grant.

Research and Application

Many foundations are concerned with the creation of knowledge through *research*—as are numerous universities and the federal government—and the great preponderance of their funds are channeled in that direction. Consequently, other philanthropic organizations, including the Kellogg Foundation, believe that there is a place on the American and World scenes for foundations primarily concerned with the *application* of existing knowledge so that there may be narrowed the gap between the creating of knowledge and its use for the public good. The efforts of the latter group, therefore, are primarily along educational and communications lines.

Organization of a Foundation

The organizational framework of foundations varies widely but perhaps the W. K. Kellogg Foundation pattern of operations is not too far from the typical, at least for the larger foundations. This foundation has six divisions: Agriculture, Dentistry, Education, Hospitals, Medicine and Public Health, Nursing, and a seventh division, Latin American, which implements the work of the six aforementioned divisions in the continent to the south of us. There is a director for each division who acts as liaison between the foundation and assisted programs and explores other possible projects to be aided. Proposals made to the Foundation are also reviewed by advisory committees made up of eminent authorities in the particular field of each division. Final selection of programs to be aided are made by a nine-member Board of Trustees and the General Director. An average of 1,300 requests for assistance are received annually and it is necessary to decline about 90 percent of these requests, either because of limited resources and prior commitments or because the proposals do not meet long-held criteria or do not fall within the Foundation's fields of current interest. Geographically the assistance during fiscal 1959 was apportioned as follows: United States, 82 percent; Latin America, 9 percent; Europe, 6 percent; Canada, 2½ percent; and Australia, one-half of one percent.

THE MOTIVES FOR GIVING

A number of rich men established foundations because they believed with John Donne that "I am involved with mankind." Some of a religious or philosophical bent saw themselves as mere stewards of money which "rightfully belongs to God and His people." There have been other motivations for the founding of organizations to serve as vehicles of giving: the desire to be remembered, vanity, guilt feelings whether justified or not, fear or dislike of taxation.

There have been accusations at official and unofficial levels that "Foundations are devices for escape from taxes." Yet most of the larger foundations which commit a preponderance

of the funds for philanthropy were established a number of years before income tax was one percent. So, long on the fortunes of the rich. In the year before Andrew Carnegie's death in 1919, the surtax on corporations through the then-six-year-old federal income tax was one percent. So, long before taxes really became burdensome, Mr. Carnegie absolved his Scotch Presbyterian conscience by carrying out his Gospel of Wealth through the purchase of pipe organs for 8,000 churches, for the building of 3,000 public libraries, for gifts to 500 universities and colleges, and to endow the beneficent Carnegie Corporation. John D. Rockefeller's much-publicized "desire to be liked" was probably more of a factor in his millions of donations than were income taxes. In 1930 when W. K. Kellogg—undoubtedly influenced by the Seventh-Day Adventist direction of "Lay up no treasures on this earth"—decided to "invest my money in people," income taxes were a mere fraction of what they are today.

The Tax Burden

Particularly with respect to a few of the smaller foundations and some formed in the last couple of decades, it is probably true that the founders were seeking to reduce their taxable income or estates through gifts or bequests to charitable, educational, and other similar causes. As grew the burden of the federal income tax, of estate and gift taxes, so grew the concern of many wealthy persons. In their desire to keep the great octopus of taxation from engulfing their hard-earned money, there was a very human preference toward using the money philanthropically, to advance a cause toward which they were sympathetic, and "to have a voice in saying how my money should be used."

Surveillance

However, a realistic appraisal of the facts of life, including governmental regulations, bureaus, and tax policies, should make it apparent that there is scant possibility that either a founder or any of the personnel of a foundation could gain monetarily from any unethical or illegal operations. Foundations, as tax-exempt organizations, are under the surveillance of both federal and state governmental agencies; most of their charters contain explicit provisions for the irrevocable philanthropic commitment of income and capital funds, and numerous foundations annually give away sums greater than their income for the year. As an example of this latter point, the W. K. Kellogg Foundation income for fiscal 1959 was $6,806,820, while its expenditures for assisted programs during the same year were $8,147,434, or an excess of $1,340,614 of disbursements over income.

There have been two Congressional investigations of foundations in recent years—those of the Cox Committee in 1952 and of the Reese Committee in 1953. A number of foundations submitted written reports of policies and operations, and detailed historical resumés. Representatives of only two or three foundations were subsequently asked for oral testimony in committee hearings but the great preponderance of foundations were not even mentioned in these sessions. Subsequent to both hearings, a considerable majority of the newspapers of the nation voiced the belief that foundations emerged

from the investigations with "a remarkably clean bill of health."

Definitely abated are the fears once held by economists concerning the power of wealth concentrated in foundations and the indefinite continuance of the wishes of their founders. Religious, philanthropic and educational endowments in the United States represent less than one percent of the national wealth; a score of life insurance companies have larger resources than any foundation; a hundred banks have incomes greater than the total new endowments of foundations any year. "The imposition of the dead hand" is prevented and desirable freedom assured by such precautions as Carnegie's which provided that the Carnegie Corporation income could, at the discretion of the trustees, be expended for purposes other than those he specified, and by legislative provisions in foundation acts of incorporation or charters that may be altered or repealed through due process.

FREEDOM AND RESPONSIBILITIES

Foundations are relatively free of the pressures of conformity and tradition and may be uniquely selective with respect to the aid they extend. They have to observe no rules of geographical distribution nor any sort of mathematical yardstick. Virtually the sole criterion for their assistance is the intrinsic merit of a program: will aid to this particular project bring the maximum social return? A foundation may even do the unpopular thing if that seems essential to the public welfare.

Under such wide latitude, foundations in the last quarter century have won a wide measure of public approval. Such approval, while gratifying, brings with it certain responsibilities. In providing their special philanthropic service to the public, the private foundations must, first of all, demonstrate wise stewardship of the funds entrusted to their care and philanthropic investment. This will continue to require the recruitment of community and professional leaders as members of their governing boards. Topnotch staffs and capable advisory committees must be in touch with authorities in every field so that the foundations' public service objectives may be attained. And in line with the "full disclosure" policy demonstrated by the recent annual reports of particularly the larger foundations, the private foundation must be ever conscious of its obligation to take the public into its confidence and periodically to render an account of stewardship of resources which have been committed to it.

For a British editorial comment on American philanthropy, see "Wholly American," p. 57.

STUART B. MEAD

Mutual Funds as an Investment

The thoughtful investor and the various objectives of different types of funds

Within the past decade the investing of savings in the shares of investment companies has shown a tremendous increase. For example, from 1950 through 1958 mutual funds have shown an increase in net assets of approximately 425 percent. Between 1955 and 1959 they doubled in size. With this increasing popularity arises the question: do purchasers of shares of investment companies realize what they are acquiring? Undoubtedly many or most do have a fairly adequate idea, but are they buying that type of fund best suited to their investment requirements?

For purposes of identification, investment companies may be separated into open-end or mutual funds, and closed-end investment companies. At the present time there are listed by the National Association of Security Dealers about 190 funds which stand ready to issue new shares or redeem outstanding shares at their net asset value, usually plus a sales commission or, for a few, minus a redemption fee. This type of investment company is known as the open-end or mutual fund.

On the other hand, about 40 companies, most of which are listed on the New York Stock Exchange, do not issue new shares regularly. They are the closed-end investment companies. Since new shares are not available, their growth, in part, depends on fluctuations in market price. Because of this and other factors that may be present, statistical comparisons between the two types of funds are rather unreal. This article will discuss only mutual funds.

In considering mutual funds the investor must realize that he does not have, through this medium, an easy solution to his investment problems. Even though he may feel that the purchase of the shares of any available

fund will solve the question, actually study or competent advice is necessary. The funds have been created for a number of varying purposes. The results of their operation vary widely. Their security portfolios differ in accordance with the purpose and policy adopted by their management. In fact, a study of the existing funds will soon convince the investor that there does not exist a fund that will give him above average capital gains, outstanding income from his investment, and safety all at the same time. Just as an investor must diversify a personal portfolio of securities in order to obtain certain results, so he must diversify his mutual fund holdings.

CLASSIFICATION

Various authors have classified mutual funds in a number of different ways. One useful method is as follows:

Common Stock Funds

Under this heading are comprised funds that maintain a portfolio containing only common stocks. An occasional deviation takes place when a limited amount may be invested in United States Governments. The investor in this type of mutual fund may anticipate a steady increase in the net asset value of his shares over a period of years. For the past decade an increase of over 100 percent could have been expected. Market recessions will result in a large percentage decrease in the value of the shares, offset by rapid and large percentage increases with recoveries. An outstanding fund should end each recovery at a higher point than before the drop. The rate of return on the fund will be relatively low.

General Funds

While a portion of the portfolio of this type of fund may be in bonds and/or preferred stocks, the primary investment is in common stocks. Such a policy should result in more controlled cyclical swings, a higher rate of return and greater price stability. On the other hand, the investor will find that the percentage increase in the net asset value of his shares will be at a slower rate and never reach the heights of the common stock fund.

Balanced Funds

The primary stress is on safety. These are conservative funds, whose policy is to maintain a predetermined relationship among the bonds, preferred stocks and common stocks in their portfolio. The investor should anticipate, in addition to price stability, an adequate rate of return on his investment, but an extremely slow and lesser increase in the net asset value of his shares. This type of fund has proved to be very popular with mutual fund investors. Of the three largest funds, two are balanced, having a total investment, as of June 30, 1959, of $2,348,113,969.

Income Funds

The intent of this type of fund is to produce a high rate of return on the investment. With stress on return, the growth in net asset value may be slight. Also high return normally is connected with decreased price stability. This means that the purchaser can expect extreme decreases in net asset values during recessions and rather slow recoveries.

Specialized Funds

The portfolios of these funds are limited to securities of firms in certain areas of production. The purchaser must be convinced that a certain production area will have greater growth over the years to come than will other areas. Funds have been created for almost all the production areas, but many of them interpret their area so broadly that the fund becomes almost a general one. Television - Electronics, for example, has in its portfolio securities of business machine firms, steel companies, industrial equipment manufacturers, producers of aircraft, chemicals, etc.

PERFORMANCE

To show the application of the above facts, Table 1 brings out the percentage increase in net assets for the eight years between 1950 and 1959 for 35 selected mutual funds. (Included are the 20 largest funds regardless of type. The remaining 15 include the five largest no-load funds—those that charge no sales commission—and a number of smaller ones that have done well in their particular area. All of the funds listed were in operation for the entire eight years). The percentages shown give the investor an opportunity to compare the growth of one fund with that of the others. While past growth is not an absolutely accurate guide to the future of a fund, it can be of assistance in arriving at a choice among them. The best performances, of course, in a period of rising prices, should be made by the common stock funds. The averages of the performance by the three primary types of funds are:

Common Stock Funds	118.7 percent increase
General Funds	98.9 percent increase
Balanced Funds	46.1 percent increase

Price Stability

In addition to this measurement of growth, a column is provided measuring the price stability of the various funds. It shows the percentage decrease as measured from the highest net asset value in 1957 to the lowest net asset value for that year. All are negative figures or decreases in net asset value: the lower the percentage, the better the performance. As has already been stated above, more stability could be expected from balanced funds than from common stock funds. The average of the decreases substantiates this point.

Common Stock Funds	33.9 percent decrease
General Funds	24.4 percent decrease
Balanced Funds	17.9 percent decrease

Recuperative Strength

Finally, a column is provided measuring the recuperative strength of the various funds. As this column shows the ability of a fund to overcome recession losses, the percentages are of significance. The most impressive rebounds, of course, should be expected by the common stock funds. The averages show this to be true.

Common Stock Funds	36.7 percent increase
General funds	31.4 percent increase
Balanced Funds	21.4 percent increase

At this point it should be added that several of the funds established since 1950 have shown excellent results as far as recovery is concerned. The following are cited as examples to show the possibility of flexibility in the newer and smaller funds.

TABLE 1

CLASSIFICATION AND PERFORMANCE OF SELECTED MUTUAL FUNDS (1950-1958)

	Size of Fund (in Millions)	Percent of Bonds, Preferred Stocks December 31, 1958	Increase in Net Assets From 1950 to 1959	Stability From High to low in 1957	Recuperative Strength From low in 1957 to Dec. 31, 1958
Common Stock Funds					
Dreyfus Fund	65.1	0	156.1%	26.2%	48.6%
Fidelity Fund	396.7	3.80	106.4	31.1	40.8
Financial Industrial Fund	136.0	0	75.3	39.5	19.1
Fundamental Investors	581.2	0	106.5	31.4	36.6
Incorporated Investors	326.6	0	100.6	44.0	40.0
Investors Stock Fund	506.0	6.39	119.8	29.6	30.3
Mass. Investors Growth Stock Fund	273.4	0	140.6	36.1	41.9
Mass. Investors Trust	1,539.8	1.20	140.5	28.9	39.9
National Investors Corp.	115.6	0	119.4	33.1	39.9
National Securities: Growth Stock Series	61.2	0	174.6	38.6	33.4
National Securities: Stock Series	187.5	0	65.9	45.1	25.7
Scudder, Stevens & Clark Com. Stk. Fund	30.3	0	118.4	23.7	44.0
General Funds					
Affiliated Fund	560.1	12.44	61.4	17.7	33.7
American Mutual Fund	112.3	19.33	66.7	30.7	24.4
Broad Street Investing Corp.	155.7	12.10	78.5	14.5	33.6
Dividend Shares	271.7	15.49	75.9	26.3	27.2
Eaton & Howard Stock Fund	153.8	10.48	130.5	26.7	34.0
Investment Co. of America	152.6	15.80	87.2	30.7	37.9
Pine Street Fund	18.1	15.99	85.6	19.8	35.6
T. Rowe Price Growth Stk. Fund	22.5	22.30	180.1	19.4	33.8
United Accumulated Fund	297.7	13.75	114.2	33.8	22.1
Balanced Funds					
Boston Fund	206.0	32.10	49.3	16.5	20.9
Eaton & Howard Balanced Fund	200.1	32.70	50.6	13.6	21.5
Investors Mutual, Inc.	1,393.5	35.05	50.2	17.8	11.3
Loomis-Sayles Mutual Fund	74.6	39.30	31.8	19.7	18.8
George Putnam Fund	195.0	36.80	55.1	21.6	27.6
Scudder, Stevens & Clark Fund	81.8	31.40	40.2	17.3	28.0
Wellington Fund	954.6	35.86	45.8	19.2	21.9
Income Funds					
Keystone Custodian Fund-K1	60.8	54.40	3.9	18.2	4.7
National Securities—Income Series	76.5	27.70	35.2	33.4	26.8
United Income Fund	233.0	7.01	92.9	28.7	23.4
Specialized Funds					
Chemical Fund	247.8	2.90	111.2	29.6	38.5
Group Securities: Aviation	3.3	0	188.0	67.8	39.5
Television-Electronics Fund	297.2	8.10	121.4	35.7	34.3
United Science Fund	101.4	5.86	137.3	32.7	28.5
Average performance of ten largest funds			96.7%	28.9%	30.1%

SOURCE: Computed from annual reports of the funds and quotations from the *Wall Street Journal*

de Vegh Investing Company
(established 1953) . . . 41 percent increase
Diversified Growth Stock Fund
(established 1952) . . . 39 percent increase
Electronics Investment Fund
(established 1955) . . . 41 percent increase
Penn Square Mutual Fund
(established 1957) . . . 43 percent increase

In spite of their recent performance, these funds have not been included because of their shorter life. Most of the funds in the study were established in the late Twenties or in the Thirties, and have weathered several dips and recoveries previous to that in 1957.

RETURN ON INVESTMENT

Table 2 continues the study of the performance of the funds being used as illustrations of what an investor may expect if he purchases the shares of mutual funds. This table brings out the percent of return on the investment in terms of income and capital gains, and the percent of expense incurred by each fund.

As funds registered under the Regulated Investment Company Act of 1940, the listed funds must regularly distribute at least 90 percent of their investment income to shareholders. Their annual dividends approximate their net income after fund expenses. The table shows the average percent of dividends paid during the years of 1956, 1957 and 1958 based on the net asset value of the fund at the end of the year.

Rate of Return

The purpose of income funds is to provide a high rate of return on investment; hence the income fund should show the best results in this respect. The averages for the various groups follow:

Common Stock Funds . . .	2.91 percent return
General Funds	3.27 percent return
Balanced Funds	3.45 percent return
Income Funds	4.91 percent return

The above figures provide evidence to an investor that he cannot expect growth and income from the same source. Common stock funds, which show an average growth of 118.7 percent, produce a return of less than three percent. On the other hand, income funds, which have a very low average growth of only 44 percent, have an investment income return of almost five percent. Certain funds are far ahead of the average. The Value Line Income Fund, established in 1952, has an average dividend record for 1956, 1957 and 1958 of 6.94 percent. This fund is closely followed by the Income Fund of Boston, established in 1954, which has produced an average return of 6.16 percent.

Income and Capital Gains

The dividends of mutual funds must be separated into two categories: dividends from income and capital gain dividends. All of the funds make this distinction. Under federal income tax regulations the two types of dividends are taxed in a different manner. Those from income are the same as any corporate dividend. As a result, the investor may take advantage of the dividend exclusion of $50 and the four percent dividend credit. Capital gain dividends are considered to be a distribution of profits resulting from the sale of assets. As the securities sold have generally been in the portfolio of the fund for a period in excess of six months, the dividend is taxable as a long-term capital gain. This means

TABLE 2

ANALYSES OF RETURNS

	Maximum Sales Commission	Average Dividends	Average Capital Gains (1956-1958)	Average Expenses Based on Income (1956-1958)
Common Stock Funds				
Dreyfus Fund	8.00%	2.18%	4.14%	27.0%
Fidelity Fund	7.50	3.58	3.29	13.8
Financial Industrial Fund	8.45	3.44	2.99	20.9
Fundamental Investors	8.75	3.20	2.75	16.8
Incorporated Investors	7.50	2.71	4.95	17.7
Investors Stock Fund	7.50	3.09	1.45	15.1
Mass. Investors Growth Stock Fund	7.50	1.99	2.68	20.6
Mass. Investors Trust	7.50	3.32	1.30	5.6
National Investors Corp.	7.50	2.51	4.90	11.6
National Securities: Growth Stock Series	8.50	2.35	3.17	31.1
National Securities: Stock Series	8.50	3.79	3.86	14.9
Scudder, Stevens & Clark Com. Stk. Fund	None	2.77	2.37	21.7
General Funds				
Affiliated Fund	7.50	3.78	4.27	11.1
American Mutual Fund	8.50	3.12	8.05	20.6
Broad Street Investing Corp.	7.50	3.94	3.24	7.5
Dividend Shares	8.67	3.53	3.68	13.8
Eaton & Howard Stock Fund	6.00	2.65	1.47	19.1
Investment Co. of America	8.50	2.87	5.98	20.3
Pine Street Fund	1.00	3.84	4.53	11.2
T. Rowe Price Growth Stk. Fund	None	2.22	4.55	28.6
United Accumulated Fund	8.50	3.43	3.19	N.A.
Balanced Funds				
Boston Fund	7.50	3.25	4.94	16.2
Eaton & Howard Balanced Fund	6.00	3.18	2.12	15.4
Investors Mutual, Inc.	7.50	3.98	1.28	11.9
Loomis-Sayles Mutual Fund	None	3.24	4.22	16.9
George Putnam Fund	8.00	3.49	3.54	15.0
Scudder, Stevens & Clark Fund	None	3.19	2.43	16.7
Wellington Fund	8.00	3.82	3.47	10.9
Income Funds				
Keystone Custodian Fund-K1	8.30	5.53	1.52	11.2
National Securities—Income Series	8.50	5.25	3.09	13.6
United Income Fund	8.00	3.95	3.51	N.A.
Specialized Funds				
Chemical Fund	7.50	2.38	3.46	19.1
Group Securities: Aviation	8.50	3.24	1.94	21.6
Television-Electronics Fund	8.25	3.08	4.69	18.7
United Science Fund	8.50	2.32	3.72	N.A.
Average performance of ten largest funds		3.42%	3.06%	13.51%

SOURCE: Computed from annual reports of the funds, and quotations from the *Wall Street Journal*

that only one-half of the amount received is taxable, a significant saving in comparison with the tax on dividends from income.

For protection of his capital investment the investor should differentiate capital gains from investment income. Capital gain dividends represent a partial return of the increase in the net assets of the fund or a return of the invested capital of the purchaser of shares of the fund. A fund has two types of gains. Unrealized ones result from the increase in the asset value of the portfolio. Realized gains arise from the sale of a portion of the securities in the portfolio.

Objective and Dividend Use

Being distributions of capital, realized profits force upon the investor a choice whether to reinvest the capital gains in the same fund or to put them in another fund or in some other investment media. The use of the dividend as if it were income would dissipate his capital. The final use of the dividend should depend upon the investment objectives of the individual. That is, if the fund declaring the capital gain dividend has been successful in attaining its objective, the dividend may be reinvested. On the other hand, if the investor has shifted his objectives, if he desires greater diversification, or if the fund is lagging, the dividend should be invested in another fund or type of investment.

Sales Commission

The final consideration in this portion of the study deals with expenses incurred by the investors and by the funds. The first cost that the investor will encounter is the sales commission in connection with the purchase of shares. As brought out in Table 2, this charge ranges from 8.67 per cent to zero. The latter is the case with the no-load funds, which have been sponsored by a number of old and reputable investment advisory firms. Among these are Scudder, Stevens and Clark of Boston, T. Rowe Price of Baltimore, J. L. Hain & Company of Reading and Wood, Struthers & Company of New York. While a few of the load funds have been created by investment advisory firms, most of them are sponsored by research corporations set up for this purpose, or have their own governing boards of trustees.

In the daily mutual fund price quotations a bid price and an ask price are given. The bid price is the one that the fund stands ready to pay shareholders or the liquidation value of the shares. The ask price is the bid price plus the sales commission. The sales commission represents an additional cost incurred by the investor, and due to its size on small purchases may become an important factor in certain cases. Of the total commission, one to three percent goes to the underwriter or sponsor of the fund. The balance represents the discount allowed the security dealer, or his commission on the sale. While the maximum sales charge is heavy on small purchases, it is scaled down on larger ones. As most mutual funds do not have a liquidation charge, the sales commission is only slightly greater than the brokerage charges on the purchase and sale of securities.

Computing the Commission

One factor to be considered in connection with the load charge is the method of computing the commission.

In most cases the funds base the load charge on the ask price, which is the bid price plus the sales commission. This would mean that the percent of commission quoted by the fund differs from the percent of commission based on the net asset value of the shares. This is the result of an accounting technique; it is a matter of which figure should be considered to be the base—the bid price or the ask price. To illustrate: a fund which has a quoted load charge of 8 percent has a bid price (net asset value) on a certain day of $14.49. The ask price would be: $14.49 ÷ 92% = $15.75, based on the following accounting concept:

Sales (ask price)	$15.75	100%
Cost (bid price)	14.49	92%
Margin (load charge)	$ 1.26	8%

On the other hand, the investor could say that his redemption value or the value of the assets behind each of his shares is only $14.49. Consequently, if he pays a load charge of $1.26, he is paying a commission rate of

$1.26 ÷ $14.49 = 8.69%

Both are correct. It is strictly a matter of the figure which you believe to be of greater significance—the net asset value or the sales figure.

Dividend Shares

A final consideration is the variation in the practice of funds in connection with shares issued in lieu of cash dividends or capital gain dividends. By agreement, funds will issue shares rather than pay the dividend in cash. The general practice of the funds is to issue these shares at the ask price, the load charge being split as on the original sale. As it seems as if there is little justification for this practice, the security dealer having completed his service with the sale of the original shares, a number of funds now issue these dividend shares at the bid price. In addition to the no-load funds the following are among those which have adopted this policy: American Mutual Fund, Dreyfus Fund, Financial Industrial Fund, Group Securities, Investment Company of America, Investors Mutual and Stock Funds, Pine Street Fund, George Putnam Fund, United Funds, Wellington Fund, and Television-Electronics Fund.

Management Fee

The second and most important expense is the management fee: what the sponsor receives for his services to the fund. This fee is generally ½ of 1 percent of the average net assets for a given period of time. A few funds have a lower charge. While the management fee may vary in certain details, the following represents the basic fee of a number of funds:

⅛ of 1 percent quarterly on average net assets: Dreyfus Fund, Financial Industrial Fund, Investors Mutual Fund, T. Rowe Price Growth Stock Fund, and Television-Electronics Fund.

1/16 of 1 percent quarterly on average net assets: Massachusetts Investors Growth Stock Fund.

½ of 1 percent annually: Fundamental Investors; National Securities; Scudder, Stevens & Clark and Penn Square Mutual Fund.

Variable rate (decreases with increase in size of fund): Fidelity Fund, Keystone Funds, Pine Street Fund, Chemical Fund, Broad Street Investing Corporation, National Investors Cor-

poration, Massachusetts Investors Trust, and United Funds.

In return for this fee the sponsor generally supervises the fund, provides the necessary research service, office space and clerical help. Considering the funds in general, the charge averages about 60 percent of the total expenses. The other expense items may vary. Generally they are trustees' or directors' fees, taxes and custodian fees. The latter represents a necessary cost for the physical protection of the security portfolio.

What does the above mean? If a fund, for example, has an expense ratio of 21 percent, it means that twenty-one cents of every dollar of income from interest and dividends is being used for operating purposes. Further, if the management fee is 65 percent of the expenses, then fourteen cents of every dollar of income goes to the group sponsoring the fund. Most of the groups sponsor more than one fund. In these cases the office expenses and research costs can be spread among the funds, leaving the balance for the sponsoring organization.

Quid Pro Quo

There has been some criticism of the amount of this management fee. From the point of view of the investor the equity or inequity of the fee becomes a matter of what he receives. The more successful funds expend time and money for investigation and research before adding a block of stock to their portfolio. The supervision of the portfolio requires additional expenditures of time and cash. Only in this way can the investor be assured of the continuing success of the fund. Many times, after the outlay of large sums of cash for investigation, the fund managers may decide that a given security should not be purchased. The safety desired by the investor is thereby assured. These are the costs that must be incurred if the investor is to receive a fair return on his investment and the net asset growth or the safety that he may desire.

Finally, there is a hidden cost that should not be overlooked. Many of the sponsoring firms have a brokerage office which acts for the fund at the usual charge. As this fee is added to the cost of the securities or deducted from the selling price in computing capital gains, it will never appear in any of the fund statements. On the other hand, it should be considered, along with the underwriting commission and the management fee, in arriving at the total income accruing to the sponsor from the sale of fund shares and the managing of the fund.

TRADING PROFITS

Lack of time and knowledge often prevents the small investor from deriving the benefits from special trading situations. The mutual funds are more or less regularly shifting their portfolios. This is done in order to show better results from operations both as to capital gains (trading profits) and as to increases in net assets. While most of the funds in one year or another may individually show large capital gains, a number of them have consistently produced trading profits during the past five years. A number of them have announced that this is their present policy.

In order to assure himself of consistent trading profits an investor would

TABLE 3

CAPITAL GAIN DIVIDENDS

	Average	*1959*	*1958*	*1957*	*1956*	*1955*
Concord Fund	10.90%	12.72%	3.35%	14.94%	17.77%	5.72%
Keystone S-4	9.76	7.31	0.00	14.93	8.64	17.95
de Vegh Mutual Fund	9.27	11.86	4.60	6.83	11.16	11.91
Keystone S-3	8.89	7.22	8.85	9.04	10.18	9.19
American Mutual Fund	7.85	6.82	4.95	10.21	9.00	8.30
Keystone S-2	6.90	9.21	6.77	8.57	5.56	4.40
Investment Company of America	6.53	7.01	3.60	6.59	7.74	7.74
Delaware Fund	5.49	6.51	4.74	5.67	5.75	4.81
Minnesota Fund	4.97	7.01	4.03	4.14	4.75	4.93
Pine Street Fund	4.75	5.88	2.83	2.99	7.77	4.31
Loomis-Sayles Mutual Fund	4.73	5.04	4.28	6.02	5.41	2.92
Affiliated Fund	4.49	4.81	2.88	4.73	5.21	4.84
T. Rowe Price Growth Stock Fund	4.47	3.69	4.25	4.51	4.90	5.02
National Investors Corp.	4.59	2.23	5.06	4.06	5.58	6.01
Incorporated Investors	4.37	5.63	2.78	6.42	5.66	1.36
Television-Electronics Fund	4.34	3.84	4.32	5.37	4.28	3.88
Boston Fund	4.06	3.27	3.36	6.12	5.31	2.25
Istel Fund	4.02	4.77	4.20	4.47	2.80	3.85
Growth Industry Shares	4.01	4.71	3.43	5.51	4.46	1.97

SOURCE: Computed from annual reports of the funds, and quotations from the *Wall Street Journal*

have to devote time each day to market reports and the analysis of situations that he might discover. Lacking this time he can accomplish at least a part of his objective through the purchase of shares of funds regularly engaged in trading operations. The fund selects and supervises the portfolio, relieving the investor of the responsibility of what and when to buy and sell. While the mutual fund may appear at first to be a rather costly means of obtaining these capital gains, the cost may well be less than the losses that could be incurred by an unskilled investor.

As previously mentioned, certain mutual funds during the past few years have consistently produced greater capital gains than others. A number of these funds are listed in Table 3. In purchasing these funds the investor should understand their purpose. The portfolios should be scrutinized, and inquiry should be made about the nature of the fund. For example, the portfolios of the Keystone S-3 and S-4 Funds consist largely of volatile, speculative or semi-speculative common stocks. At the other extreme are the deVegh Mutual Fund, the Boston Fund, the Loomis-Sayles Mutual Fund and the T. Rowe Price Growth Stock Fund, whose portfolios contain mostly high grade securities, including preferred stocks and corporate bonds. Others, such as the Pine Street Fund and the Television-Electronics Fund, have portfolios made up of both high grade and semi-speculative stocks and bonds.

PERFORMANCE DURING 1959

According to the reports released by the National Association of Investment Companies, the total net assets of all mutual funds in 1959 increased

by almost $2 billion. This represents an increase of only about 2 percent over the net asset value in 1958. The slowdown in growth was caused by a decided increase in redemptions that took place during the year.

As the funds must live in the market, certain facts regarding a highly unpredictable market should be considered. In the first place, certain of the funds studied did better than the market averages. During the year the Dow-Jones Industrial Average rose 16.4 percent. Four of the funds showed percentage increase in net assets above this figure (Table 4). But ten of the funds showed better results than the Dow-Jones 65 Stock Average, which rose about 8 percent. The latter average is more comparable, as it has the breadth and diversification sought by the funds.

The Factor of Flexibility

The market was also selective and volatile. A fund manager was unable to buy just any security and show results. Funds heavy with oils fared badly. As well illustrated by the specialized funds, those stressing electronics, chemicals and missiles were strong. The smaller and more flexible funds showed their advantage in this respect once again. Some of the giants, which must buy and sell in extremely large lots, were unable to alter their portfolio with the success attained by the smaller funds. Many writers feel that flexibility will again be of importance in 1960.

Table 4 also shows the poor performance of the balanced funds. During 1959 the bond market steadily dropped. The result of this decline affected not only the balanced funds but also the general funds, though to a lesser extent. While all funds have reflected the decrease in the stock market during the early months of 1960, the steadying of bond prices has made the drop less spectacular in the case of general and balanced funds than in the case of common stock funds.

The Factor of Capital Gains

The number and size of the capital gain dividends during 1959 is an additional factor of importance. With few exceptions, the realized gains distributed by the funds were in excess of three percent. California Fund, Concord Fund, Corporate Leaders and Group Securities — Aviation declared capital gain dividends ranging from 12 to 16 percent. By classes, the average capital gain dividends of the funds studied were as follows:

Common Stock Funds	2.90 percent
General Funds	4.09 percent
Balanced Funds	3.54 percent
Income Funds	3.08 percent
Specialized Funds	6.47 percent
All Funds Studied	3.76 percent

As is explained above, a capital gain dividend is the distribution of a portion of the net asset increase of a fund. To obtain the true performance of a fund in any given year, the capital gains should be added to the unrealized increase in net assets. A column showing these results has been provided in Table 4. This gives the complete picture of what the management of a fund attained in 1959. For example, while the holders of shares in the Scudder, Stevens and Clark Fund saw the net asset value of the fund decrease by

TABLE 4

PERFORMANCE FOR 1959

	Increase (decrease) in Net Assets	Capital Gains	Increase plus Capital Gains	Dividends
Common Stock Funds				
Dreyfus Fund	20.12%	1.98%	22.10%	1.98%
Fidelity Fund	4.34	3.21	7.55	2.68
Financial Industrial Fund	9.95	3.37	13.32	2.42
Fundamental Investors	5.80	2.07	7.87	2.38
Incorporated Investors	4.33	5.63	9.96	1.78
Investors Stock Fund	8.53	1.81	10.34	2.24
Mass. Investors Growth Stock Fund	11.11	2.50	13.61	1.45
Mass. Investors Trust	4.42	0.85	5.27	2.79
National Investors Corp.	13.16	2.23	15.39	1.79
National Securities: Growth Stock Series	21.75	2.28	24.03	1.37
National Securities: Stock Series	3.36	3.29	6.65	3.88
Scudder, Stevens & Clark Com. Stk. Fund	5.31	5.65	10.96	2.26
General Funds				
Affiliated Fund	4.61	4.81	9.42	2.94
American Mutual Fund	1.31	6.82	8.13	2.60
Broad Street Investing Corp.	2.01	1.85	3.86	3.40
Dividend Shares	0	3.20	3.20	2.86
Eaton & Howard Stock Fund	6.03	1.21	7.24	2.26
Investment Co. of America	4.09	7.01	11.10	2.34
Pine Street Fund	(1.85)	5.88	4.03	3.25
T. Rowe Price Growth Stk. Fund	11.44	3.69	15.13	1.69
United Accumulative Fund	9.21	2.34	11.55	2.89
Balanced Funds				
Boston Fund	(0.56)	3.27	2.71	2.97
Eaton & Howard Balanced Fund	(1.51)	2.18	0.67	3.10
Investors Mutual, Inc.	4.73	2.23	6.96	3.48
Loomis-Sayles Mutual Fund	(3.48)	5.04	1.56	3.04
George Putnam Fund	5.07	3.76	8.83	2.38
Scudder, Stevens & Clark Fund	(0.97)	4.85	3.88	2.92
Wellington Fund	2.01	3.39	5.40	3.24
Income Funds				
Keystone Custodian Fund-K1	(1.29)	2.61	1.32	5.22
National Securities—Income Series	2.75	3.15	5.90	4.57
United Income Fund	2.58	3.50	6.08	3.15
Specialized Funds				
Chemical Fund	16.86	3.19	20.05	1.80
Group Securities: Aviation	(13.57)	16.14	2.57	2.47
Television-Electronics Fund	15.98	3.84	19.82	2.00
United Science Fund	19.04	2.71	21.75	1.36
Average performance of ten largest funds	6.40	3.02	9.42	2.64

SOURCE: Computed from annual reports of the funds, and quotations from the *Wall Street Journal*

about one percent, a capital gain dividend of 4.85 percent, if reinvested, would have left them with an increase of 3.88 percent for the year. The last figure is a much better criterion of what management accomplished than either of the other two figures. Making use of the percentages in this total column, it will be observed that about one-half of the funds studied showed better results than the Dow-Jones 65 Stock Average.

Rate of Yield

While the dollars in dividends paid by listed corporations during 1959 increased, the yield rates for the funds studied decreased. With growth in net asset value this must be expected. The averages by groups follow:

	Average Percent of Dividends 1956-1958	1959
Common Stock Funds	2.91	2.25
General Funds	3.27	2.69
Balanced Funds	3.45	3.02
Income Funds	4.91	4.31
Specialized Funds	2.75	1.91

In fact, of all the funds listed by the National Association of Security Dealers, only two had a dividend rate in excess of 5.0 percent. The Value Line Income Fund produced a 5.40 percent return and Keystone K-1, 5.22 percent.

EVALUATION

Mutual funds give the small investor an opportunity to obtain diversification and yet invest small amounts at any one time. For many investors, necessary diversification is out of the question. Through the purchase of shares in one or more funds, the investor is relieved of this problem. At the same time he is pursuing his own investment objectives. When an investor is buying mutual funds, there are certain points for him to consider.

Growth in Net Assets

Especially in the case of the smaller funds, the increase in net assets must be studied. A sizeable block of securities of one or two highly successful growth companies will produce a greater increase in the net asset value of the smaller fund than of the larger fund. When there are only twenty or thirty stocks in a fund, a large holding of one growth stock will produce a higher percentage of increase in the net assets than when there are several hundred securities in the portfolio. The Dreyfus Fund, the T. Rowe Price Growth Stock Fund and the National Growth Stock series illustrate this point.

Scrutiny for the Long Haul

The portfolio of a fund should be scrutinized carefully prior to purchase. A mutual fund is a long-term investment. The investor should think in terms of five years, ten years, or a lifetime as far as this type of investment is concerned. The primary reason for this attitude is the result of what a purchaser of a mutual fund can reasonably expect to obtain — sound investment counsel. A successful fund automatically passes this along to each new purchaser. This is the reason for the size of the successful funds.

Professional Management

One of the reasons for buying mutual funds is to secure the professional management services that they should provide. But the practice of certain

funds in filling their portfolios with large blocks of high grade investment securities is hardly affording buyers the service due them. The heavy loading charge and sizeable management fee should reward the purchaser with something more than he could have obtained by consulting any reputable broker. This should not be construed to mean that a fund should not have any blue chips. A few are needed to assist in growth and price stability. In fact, some may be in the portfolio as a result of the services mentioned below.

There are services which funds can and do render to their investors. Many of these investors, particularly the novices, do not have the time, the knowledge, or the inclination to study unknown, small companies in order to discover future growth possibilities. Most of the funds have a research staff to look for these potential blue chips, thus providing a service of great value to the small investor.

Another possible service, that of using mutual funds as a means of obtaining trading profits, has been discussed previously. With unsettled market conditions and high prices for high grade common stocks this phase of mutual fund investment may become a more important consideration on the part of investors. In fact, the capital gain figures for 1959 reveal the importance of this phase of mutual fund ownership.

Accomplishment and Potential

In making comparisons in this study, stock market averages, for the most part, have been avoided. Instead a number of fund averages have been introduced. While these averages may be of assistance, the best criterion is, "What can you do on your own?" If, as an investor, you are able to better the stock market averages or the fund averages, the purchase of mutual fund shares should hardly be considered. But if you are a novice, if you are unable to obtain any degree of diversification, or if your investments lag behind the averages, mutual funds may assist you.

Finally, it should be repeated that any given mutual fund will never give the purchaser all that he desires: large capital gains, high income and price stability. Diversification of fund purchases is the only answer, with emphasis on that type of fund giving the investment result most desired by the investor. An investor must first decide what he desires most. Having reached this decision, he would first buy that type of fund leading to his primary goal. But he may find two funds, both of which are attractive, or he may have a secondary goal. Through the purchase of shares in more than one fund, he attains fund diversification. In this way the buyer may protect himself against a temporary lag in a given fund and, at the same time, gain varying investment objectives.

CONCLUSION

In closing, it should be understood by the reader that this article is a study of mutual funds in general and not a recommendation to purchase any given one. Many small funds and all of the more recently established ones have, of necessity, been omitted. To name a few that have shown better than average results, the following also might have been included in the study:

Aberdeen Fund, Diversified Growth Stock Fund, Electronics Investment, Founders Mutual Fund, Growth Industry Shares, Investment Trust of Boston, Penn Square Mutual Fund, Philadelphia Fund and Putnam Growth Fund. A large number of funds have not been mentioned because they are too small, too highly specialized or have done very little in the way of growth. It must be remembered that study or competent advice is necessary prior to the purchase of mutual fund shares.

Wholly American

It is possible to defend the argument that it is more important to design a society than to plan and execute a work of art; and for the past century the Americans have been so busy building their society to meet their own needs that they might excusably have neglected the arts for the practical sciences.

What is impressive is that they have found time for both. If neither a Bach nor a Michelangelo has as yet appeared in Detroit a splendid mass of evidence has been assembled to point the way. Not only is the talent visible in ever-increasing quantity but the facilities for using it exist as nowhere else. The great foundations and the universities have led the way; but it is worth noticing—since so much is made of the fact that the culture of the United States is based upon a materialist society—that no social group in history has been so willing to spend money on the arts and sciences as the American rich.

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HENDRIK ZWARENSTEYN

The European Common Market

An analytical description of the European Economic Community in its historical and geographical context

The Treaty of Rome in 1957 establishing a European Economic Community (part of which will result in the creation of a European Common Market) has enjoyed increasingly wide attention on both sides of the Atlantic Ocean and in other parts of the world. It therefore seems appropriate to discuss a few aspects which are generally overlooked in the American writings on the subject. Furthermore, it seems fitting, in the course of a description of the historical development of the European effort to arrive at some form of closer economic cooperation, to point out some common misconceptions.

The area which makes up the European Economic Community encompasses the territories of Belgium, France, Western Germany, The Netherlands, Italy, and Luxembourg.[1] Its surface extends over some 449,000 square miles (compared with 3,022,000 square miles for the United States). All statistics for the latter exclude Hawaii and Alaska. The total population comprises 165 million people (compared with 170 million in this country). The 1,800 miles distance from Amsterdam to Palermo requires 8½ hours of air travel, or 44 hours by train. The population density averages 379 (compared with 54 in the United States): it conceals details such as the relative density of France (205 per square mile) and The Netherlands (870 per square mile). Land use is as follows: arable land 41 percent (U.S. 25 percent), meadows 22 percent (U.S. 33 percent), forests 21 percent (U.S. 32 percent), other land 16 percent (U.S. 10 percent), area covered by water not given.

The statement that the area is of significant economic importance can be easily substantiated. The world trade volume amounts to roughly 23 percent of total world trade ($42.5

billion), compared with a United States volume of 17 percent ($29.5 billion) of total world trade. In fact, the combined volume of the three small Benelux nations—Belgium, The Netherlands, Luxembourg — amounted to approximately 16 percent of world trade in the immediate post-World War II years.[2]

A breakdown of participation in world trade of the Common Market partners during the year 1957-1958 shows: Benelux $13 billion, Western Germany $14 billion, France $10 billion, Italy $5.5 billion.

THE GOALS

On March 25, 1957, the Treaty for the Inauguration of a European Economic Community (EEC) was signed at Rome. This treaty was subsequently ratified by the six partners, Belgium, France, Western Germany, The Netherlands, Italy, and Luxembourg. The treaty became effective on January 1, 1958.

As several of the participating countries have overseas territories, these territories are admitted as associate partners in the Community. Furthermore, the joining of other countries is welcomed.[3] The European Economic Community is founded on the following principles:

1. A Common Market is to be established for all products; this will be accomplished by:

- A customs union (progressive elimination of tariffs and quantitative restrictions on the movement of goods);
- The introduction of a common tariff in relation to non-participants;
- A common course of action in matters of tariffs and trade, as regards countries outside the Community;

2. Free passage of persons, services and capital within the territory encompassed by the EEC;

3. Harmonization of public regulations pertaining to:

- wages, social security legislation, competition;
- agriculture and transportation (to bring about a common policy);
- monetary and fiscal policies (to develop some degree of co-ordination);

4. The establishment of a European Investment Bank and a Fund for Professional Training and Promotion of Mobility of Workers (so as to cause the least possible friction because of adjustments due to migration).

The European Economic Community is to be effectuated in three stages, of approximately four years each, with a maximum of 15 years' total allowed in case of unforeseen difficulties which otherwise might lead to undue hardships.

During the first phase a gradual reduction of tariffs will be the main external aspect of the new venture. Gradually the abolition of trade barriers will gain significance; the third stage will be the completion of the economic union in all the projected aspects.

From these introductory remarks it should be clear that the so-called Common Market is only one of several goals

of the farther-reaching and more incisive European Economic Community.

HISTORY

Lately, the impression has been created that this development toward an economic integration is something new to Europe. Moreover, this impression is usually accompanied by the assertion (or implication) that American example and American encouragement are to a substantial degree the moving causes for the European efforts. This statement can be illustrated by some representative opinions of qualified observers.

- On May 16, 1958, in an address, "The European Common Market," Leonard Rist, Economic Director of the World Bank, said,

> The rather bold concepts which underlie what we call the "Common Market" are directly attributable to the achievements of an American, Mr. Paul Hoffman.

- In May, 1959, Thomas D. Cabot, President of Godfrey L. Cabot, Inc., and chairman of the Subcommittee on International Economic Policies of the Committee for Economic Development, said, with regard to the European Common Market:

> Its achievement will clearly be one of the most significant accomplishments of the Twentieth Century. Behind its striking significance, however, is something more.
>
> This is a great ambition of these Europeans to move on, after carving out their own unified trading area, to achieve the benefits of political and economic unity as the United States of America has done . . . for the European Common Market (ECM) must be looked upon as part of the evolving integration of Europe which has been going on since World War II.

- In the January, 1960, issue of the *Journal of Marketing* (pp. 45 et seq.) in an article entitled "European Markets and American Business," the authors (Stanley V. Malcuit and Reuben E. Slesinger) make the following statement:

> Through its various aid and assistance programs the United States was instrumental in generating economic reconstruction in most of the free nations of Europe. Soon it became apparent that some type of economic union on the continent would be essential if these nations were to raise their production goals significantly.

Let us now look into history to either verify, reject, or amend these suggestions. I do not propose to go back to the Middle Ages, or the days of the Hanseatic League, since that might be considered as reaching back too far. But I should like to suggest that we look into the history of Europe in the years following the Napoleonic period. If we do so we will find that several sincere efforts were made (some of them more successful than others), to strive toward economic cooperation, particularly through customs unions. Even if only little materialized, the discussions were thorough-going and the attempts clearly discernible. Let us consider several of these attempts.[4]

The Zollverein. The German *Zollverein* (Custom Union) was formed during the years 1819-1822 by the incorporation of several small principalities in central Germany and operated particularly in the Prussian customs district. In fact, as a result of the joining of the free ports Bremen and Hamburg (in 1888), this Zollverein was a rather successful attempt at closer economic cooperation.

Around the year 1835, a Dutch cabinet minister suggested that Holland too join the Zollverein, but because of

the refusal by the Dutch cabinet to accept the proposal the suggestion never materialized.

The Austrian Proposal. In 1849 Austria proposed to unite in a similar fashion Belgium, Denmark, Germany, Austria, Hungary, Italy, and The Netherlands; this attempt, however, failed to meet with success. Even Austria and Hungary were kept outside the Zollverein, chiefly because of Bismarck's fear that such a move —which would bring the Austro-Hungarian group into the German economic union—would weaken the political influence of Prussia.

As a result of the refusal by Germany to admit Austria and Hungary into the Zollverein, these countries contented themselves with the establishment of an Austro-Hungarian Customs Union in 1878. Though geographically speaking this undertaking was on a limited scale, it was rather successful, and lasted until World War I.

The Franco-Belgium Customs Union. Elsewhere in Europe, negotiations had gone on in 1835 for the establishment of a Franco-Belgian Customs Union. With utter disregard for the fact that this proposal failed to meet with success, another suggestion was launched in 1879, for the establishment of a Southern European Customs Union, to comprise France, Belgium, Italy and Switzerland. Like its predecessor, this one failed to meet with success.

Accession. Besides these attempts to actually establish customs unions as the main purpose of the projected negotiations, other forms of customs unions can be identified: those that came about as a result of what might be called accession of one country to another country. Examples of this kind are:

- *The attachment of the Principality of Monaco to France* in 1865, a form of economic rapprochement which still exists;
- *The integration of the Principality of Liechtenstein with Switzerland* in 1924, undoing the declaration of 1852 whereby Liechtenstein had been declared a part of the Austrian customs system.

The Serbo-Bulgarian Customs Union. In 1906 a Serbo-Bulgarian Customs Union was formed. This Union had as its primary goal to effectuate an exchange of the industrial and agricultural products of the two countries, without giving consideration to the problem of how to deal with products of foreign origin (that is, without adopting a uniform customs tariff for products from foreign sources). With the geographical and political changes following World War I this Union came to an end.

The Belgo-Luxembourg Customs Union. In 1921 a treaty was concluded between Belgium and the Grand Duchy of Luxembourg, establishing the Belgo-Luxembourg Customs Union. It should be noted that Luxembourg had been a member of the German Zollverein since 1842. With the changes following World War I a new alliance was sought and found. This Belgo-Luxembourg Customs Union lasted until the amalgamation into the Benelux Customs Union in 1948.

The Oslo Pact. Concluded among Belgium, Denmark, The Netherlands,

Norway and Sweden, this had the purpose of arriving at some form of closer economic cooperation. It was to be followed by further negotiations.

The Treaty of Ouchy. This was drawn up in Switzerland in 1932; it grew out of the Oslo Pact but was only signed by Belgium, The Netherlands, and Luxembourg. The purpose of this treaty was a lowering of the tariffs and a more liberal regulation of quantitative import restrictions.

The Scandinavian countries, however, did not enter into the signing of the Treaty of Ouchy, presumably because of their preponderant trade interests in England and Germany, combined with the fact that the latter two countries had not indicated their stand with regard to the treaty of Ouchy, and furthermore because of the most-favored-nation clause.[5]

This clause provides that if bilateral agreements are made with third countries, the specific import tariff provisions will also be available to the most favored nation. For instance, if Norway and England have granted each other the position of most favored nation, then, if Norway were to conclude a bilateral trade agreement with The Netherlands, allowing The Netherlands to export a certain quantity of woolen yard goods into Norway at a specially low import tariff, this special tariff would also apply to shipments of English woolen yard goods into Norway.

The original idea behind this practice was to prevent partiality and promote equality in dealings among nations. In practice, however, nations avoided entering into treaties of commerce because such treaties usually purported to grant the contracting nations the status of most favored nation and this would vitiate the usually meticulously set up import tariffs of the nations involved.

Although there would be reason for stating that the results of the Treaty of Ouchy were paper results rather than actual ones, it should be borne in mind that this treaty formed the basis for further negotiations between the governments of Belgium, The Netherlands, and Luxembourg. These negotiations were continued even during the years of World War II, by the governments in exile in London.

The Benelux Customs Union. After World War II (or rather, at the close of World War II—the treaty being entered into in 1944, in London, while the war was still raging in part of the Lowlands) the first renewed attempt for close economic cooperation was made by the establishment of the Benelux Customs Union. Usually we find the year 1948 given as the official date for its establishment. Be that as it may, it should not be overlooked that it took until 1955 before the many details were worked out and the Customs Union became wholly effective.

The OEEC. In 1949, the Organization for European Economic Cooperation (OEEC) was formed; the great stimulating force was the American encouragement following the Marshall Plan. Today the OEEC countries (17 in all) are often identified as the countries connected with NATO and other forms of American-European cooperation, in which prominent Americans such as Paul Hoffman and Averill Harriman have been influential.

In the same year the Council of Europe was formed to bring about an-

other type of European cooperation; much of the efforts have been geared toward the political ends of closer cooperation. Great stimulating forces were the efforts of Belgian Paul Henri Spaak, British Winston Churchill, and French Robert Schuman. European parliaments recognized the Council of Europe by delegating members to attend its sessions.

The European Coal and Steel Community. In 1952 the proposal of the French Minister of Foreign Affairs, Schuman, resulted in the establishment of the European Coal and Steel Community, with the purpose of effectuating a fast postwar restoration by making available to the participating countries the resources of Western Europe, and by setting up a supranational control of the raw materials which had so often in the past been the cause of international friction. The High Authority of the European Coal and Steel Community has legislative and executive power superseding many of the national regulatory powers.

The Treaty of Rome. Finally, in 1957, the Treaty of Rome was signed, establishing a European Economic Community, part of which has resulted in the evolvement of the European Common Market, in which Belgium, France, Italy, Luxembourg, The Netherlands, and Western Germany cooperate.

It readily follows from the above historical sketch that considerable time and effort have preceded this latest evidence of a true desire for closer cooperation, both economically and politically.

Although it seems unquestionably true that without American encouragement and example the European postwar attempts would have been less impressive (and consequently less effective), it seems just as clear that the European efforts during the past hundred years cannot, and should not, be underestimated or underemphasized.

EXPECTATIONS

It seems only logical that the question which comes up for consideration is what may be expected from this European Common Market. Without giving a detailed answer, it can be stated by way of generality that although the Common Market is barely developing its first stage, a number of nations are in the process of seriously considering what relationships to adopt with regard to it. As far as Europe is concerned, one can distinguish between the Common Six (the six member nations who make up the Common Market and their associate members) and the Outer Seven (Austria, Denmark, Norway, Portugal, Sweden, Switzerland, the United Kingdom) who are combining their efforts in an attempt to create a European Free Trade Area. It is too early to properly assess the intrinsic value of the Free Trade Area; some politically astute observers have denounced it as an attempt to stave off the bad effects of the Common Market by encouraging a free flow of goods between the participating countries and other measures of unification of the public control of trade, finance, agriculture and labor.

American business circles so far have not paid a great deal of attention to the problems which a Free Trade Area might create. This might be partly because U.S. exports to the Common Market slightly exceed those to the Free Trade Area (in 1958 they

were \$1.8 billion and \$1.6 billion respectively).

Understanding the Difficulties

On the political side there is the problem that the split between the Common Six and the Outer Seven forces the United States government into a rather uncomfortable situation. As recently as January, 1960, talks were conducted in Paris wherein C. Douglas Dillon, the United States Undersecretary of State, persuaded the European nations to set up an Atlantic Economic Community, consisting of some 20 nations (the Common Six, the Outer Seven, Canada, Greece, Iceland, Ireland, Spain, Turkey, the United States). The preceding discussion of the historical development in Europe might serve as an omen: on one hand we have the experience of Austria and Hungary in attempting to form their own customs union because of Prussia's refusal to admit them into the Zollverein, on the other hand the experience of failure of the attempts to form a Franco-Belgian Customs Union, and the subsequent suggestion for the creation of a much larger Southern European Customs Union. So we see in the present situation that before even the more limited attempts to create economic and political cooperation are realized—in fact, while the nations involved are trying to iron out their difficulties—a new program is submitted involving more nations (and consequently, threatening more difficulties). Until the underlying reasons for the present and possible future difficulties are fully understood, there seems to be wisdom in the familiar admonition that one should not rush in where angels fear to tread.

To a certain extent, the same holds true for the businessman who contemplates reaping the optimal benefits of the European efforts toward economic cooperation: headlines such as "Yankee Service Firms Rush Into Europe, Spur its 'Americanization'" (*Wall Street Journal,* January 4, 1960), or "Yank Firms Reshuffle Plants, Output To Tap Enlarged Sales Area" (*Wall Street Journal,* December 9, 1959) are indicative of the mood-to-act of American business. But "solving problems as they arise, instead of in advance, leaves a great deal to trust" warns the *Economist* of November 28, 1959. The latter statement, characteristic of much prudent European behavior, is in rather sharp contrast to the confident action of American consultant firms, Slenderella, Hertz Car Rental Service, and a score of other service organizations in establishing branch offices in Europe. Perhaps the American effort can be best summed up by the statement made by the *Wall Street Journal* (December 9, 1959):

> Alert businessmen are attempting to weld the Continent into a giant and efficient economic unit at a far faster pace than the slow schedule —a dozen years or so—that Europe's politicians have set up.

This rather exuberant summary is probably in part caused by the prospect that the new European economic framework will lend itself to the familiar concept of mass-production and mass-distribution which are so typical for the American method of doing business.

However, there are undeniably some

headaches for American industries which should not be belittled. I.B.M., for instance, used to build electric typewriters in five different locations in Europe; this policy was prompted because the independent sovereign nations of Europe each maintained its own trade barriers. As a result of the Common Market, and the subsequent economies by plant concentration and efficient transportation systems from centrally located spots, only two plants will be needed. The other three plants will possibly be converted for the production of computers and accounting machines. The big American car manufacturers—General Motors, Ford Motor Company and Chrysler Corporation—are facing problems of a similar nature. Ford, for instance, has three plants (Amsterdam, Antwerp, Cologne) so close to each other that more economical assembly and transportation can be achieved by concentrating the operations in one plant and by closing the other two facilities, or shifting them from assembly to manufacturing.

This problem will be even more vexing for those business enterprises which, unlike the above-mentioned one, have heretofore had little or no experience with company owned and operated branches in Europe. It is, therefore, important to point to the work of at least one American institution, the Chase Manhattan Bank of New York. Not only does this bank publish an important bimonthly Report on Western Europe, but it has on various occasions consulted with a well-known European expert on economic cooperation in Western Europe, Max Kohnstamm. Prior to his employment by the Dutch rayon industry Dr. Kohnstamm was employed by the Dutch Ministry of Economic Affairs and had an important part in shaping much of the present European economic framework. As another instance of American awareness of European business matters, the First National Bank of Chicago publishes an Outlook for Business in Europe.

Evaluation of Purpose

It might well be that one of the causes for misapprehension of the true challenge posed by the establishment of the Common Market lies in an improper evaluation of its purposes. The earlier quoted opinion of Thomas Cabot as to what may be expected of the European Common Market ("to achieve the benefits of political and economic unity *as the United States has done*") seems fairly representative of the American view.

However, inasmuch as the European Economic Community is located in Europe and has to function in Europe, it might be wise to listen to what responsible and well-qualified European leaders are thinking. In the *Saturday Review* of January 16, 1960, there appears an extensive report on addresses given by Sir Oliver Franks (England), Paul Van Zeeland (Belgium), and Axel Iveroth (Sweden). If there is one thing that emanates clearly from these addresses (delivered by trained diplomats and, consequently, couched in carefully chosen language) it is the assertion that there is a "European approach" to the problem of a European Economic Community (the term is Van Zeeland's), and an American approach. The European approach stresses the economic unity (at least

for the immediate future), whereas the American approach is one unmistakably directed toward a political unity; the latter view is clearly expressed by William C. Foster in his reply to Van Zeeland's address.

The European Approach

There are more views, however, which deserve mention. In "The Outlook for Business in Europe for the First Six Months of 1959," published by the First National Bank of Chicago, we find the following opinions expressed by leading bankers in Western Europe. The italics are supplied by the author.

- The chairman of the Board of Directors of the Banque de la Société Générale de Belgique:

> The introduction of the Common Market is likely in coming months to alter considerably economic prospects, *but its implications are difficult to assess at this time.*

- The Manager of the Credit Lyonnais, of France:

> The possible consequences of the lowering of tariffs within the European Economic Community after January 1, 1959, are an *added element of uncertainty* in the minds of many.

- The General Manager of the Banca Nazionale del Lavoro, of Italy:

> A *stimulus might come* from . . . the necessity for preparing to face new conditions created by the Common Market.

- The Managing Director of the Amsterdamsche Bank, The Netherlands:

> The effects of the first stage of tariff reductions and quota increases in the framework of the Common Market are not expected to be visible in the first half of 1959.

SPECIFIC PROBLEMS

It should be kept in mind that these reports are all directed toward an American readership and, consequently, prudently worded. But even though the words are carefully selected, it is rather obvious from the above-quoted opinions that there is not that certainty of glowing success that permeates American expectations. If we now look into statements directed toward the home audience, the question becomes even more poignant. As a case in point, let us turn to a leading Dutch economic publication,[6] in which one of Holland's leading bankers and well-qualified authorities on the subject states his opinion. The author, K. P. van der Mandele, points out that abolition of import restrictions may lead to a greater trading territory, but not necessarily to a market of the American type. This premise is mainly based on the differences which exist in nearly every aspect of the two societies, whether ethnological, cultural, or economic. In fact, this differentiation of ethnological, cultural, and economic aspects may even be the strength of Europe's production pattern. It seems an almost rhetorical question whether Europe should not continue to concentrate on small-scale, highly differentiated production of high-quality products (the Swiss watch industry might be mentioned as a case in point), and thus attain what economists describe as comparative advantage.

Furthermore, lowering of the tariff may well result in economic disturbances in such a fashion that a trade diversion will occur, in that different sources of origin of raw materials, semi-finished, or finished products may

result in a drastic change of the means of transportation. Rhine shipping may change completely, and so may ocean transportation, for that matter.[7]

Another aspect which deserves attention is that—apart from the problem of harmonization of a tariff policy (some countries have "specific" tariffs, other countries have an "ad valorem" duty system)—a common tariff will result in a lowering of the tariff for some countries, but a raising of the tariff in other countries (particularly in countries that have no raw materials of their own but must import these for their heavy industry). This, in turn, may lead to a disturbance in the traditional raw materials markets because of forced increase of trade between the partner nations, and subsequently to a higher cost of production in those countries that previously used to have a low tariff. This might ultimately have an adverse effect on the needed exports of these countries.

National Reservations

To return to van der Mandele, he goes on to point out that it should not be overlooked that France is heavily committed in its overseas holdings; so is Belgium, and so, to a lesser degree, are The Netherlands. As for Germany, there is the hard reality of a divided country, posing problems of a peculiar and still different nature. Apart from these general observations, one may encounter many other specific reservations about the Common Market and its implications for the various national economies. Particularly in the agricultural sector much trouble can be expected; this was true for the Benelux Customs Union and it seems to be applicable for the Common Market. Another sector of industrial activity which may pose problems is the textile industry. This is brought out in the Annual Address of the President of the Chamber of Commerce and Industry for the Eastern District of The Netherlands (an area noted for its rayon and cotton textiles). In general, the immediate prospects of the textile industry seem rather favorable: between 1955 and 1959 exports to the partner nations rose from 15 percent to 36 percent of total production. But, for the future, a concentration of industrial capacity seems to be indicated if the present status is to be maintained. This applies to the total picture of industrial activity in the textile sector: however, for the lace industry, the picture is less rosy, because of an increasingly sharp competition and a method of operation characterized by a narrow margin of profit. For the burlap industry the situation might even become critical (although this is not caused by the problems of the Common Market).

ENCOURAGING FACTORS

Fortunately, there are also optimistic notes coming from Europe. Heavy French investments in the steel, chemical, and textile industries point in an encouraging direction. In fact, in a recent article in Holland's distinguished *Maatschappij Belangen,* the former Director-General of The Netherlands Ministry of Economic Affairs, P. A. Blaisse, describes the present trend in France as one which may make it one of the strongest partners in the Common Market.[8]

The newly-appointed professor of Commercial Law at the Rotterdam

School of Economics elected as the topic for his inaugural address no less a subject than the possibility of creation of a European Business Corporation.[9] This address has already caught the attention of many leading authorities in Europe. For American business enterprises contemplating engaging in business on the European continent this development might prove to be of far-reaching effect.

And finally, in the October bulletin of Holland's venerable Society of Trade and Industry one can find the following admonition of the economic-legal sociologist and philosopher J. H Bierens de Haan:

> Europe can only maintain its position in this world if it grows toward an economic, political and cultural unity . . .[10]

Better than any other statement found so far, the latter opinion clearly reflects the prevalent feeling that the European Economic Community will—by necessity — eventually become a reality, even if not as soon as and in the manner that we here in America expect.[11]

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1. The data in this part of the article were computed on the basis of H. Th. Vreede, *A Profile of the European Market,* Amsterdam: The Twentsche Bank N.V., 1958.

2. Georges De Leener, *L'Union Economique Hollando - Belgo - Luxembourgeoise,* Brussels, Belgium, 1945, p. 11.

3. Greece and Turkey, both belonging to the Organization for European Economic Cooperation (OEEC), have indicated their interest in joining the European Common Market (ECM). Latest reports are that negotiations are taking place to admit these countries as associate members of the Common Market.

4. De Leener, *op. cit.* pp. 21 *et seq.*

5. J. B. Vink, Preface to *Resultat du Referendum de la Chambre de Commerce Neerlandaise en Belgique á Bruxelles,* Brussels, 1932, p. 16 (in Dutch) and p. 32 (in French).

6. K. P. van der Mandele, "Een Sprong in het Duister," *Economisch Statistische Berichten,* XLII, 2,073, March 20, 1957, p. 224.

7. It might be of interest to point out that a General Agreement on Trade and Tariffs report, "The Possible Impact of the European Economic Community, in particular the Common Market, upon World Trade," discusses this problem in a different manner. As opposed to the views expressed in this report, see M. E. Kreinin, "On the 'Trade-Diversion' Effect of Trade Preference Areas," in the August, 1959, issue of the *Journal of Political Economy.*

8. P. A. Blaisse, "De Nederlandse Handelspolitiek," *Maatschappij Belangen,* nr. 11, 1959, pp. 586, 589.

9. P. Sanders, "Naar Een Europese N.V.?", Zwolle, 1959.

10. *op. cit.*, n. 10, 1959.

11. Literature on the Common Market is being systematically compiled by the Europa Instituut of the University of Leyden, Leyden, The Netherlands.

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The Consent Decree

An examination of the negotiated settlement in antitrust administration and enforcement

Several recent and important antitrust cases have been disposed of by consent of the parties, rather than through court trial. Cases involving IBM, AT & T, Eastman Kodak, and United Fruit have been concluded in this manner.

A consent settlement in an antitrust case is a compromise between the two parties to the suit, the terms being fixed by negotiation, not litigation. No evidence is presented, no trial is held, and the defendant does not admit a violation of the law.

Nowhere in the statutory provisions of our antitrust laws can one find a specific statement referring to the consent settlement, except in Section 5 of the Clayton Act. In this section the provision recognizes the existence of such procedure merely by a reference to its unavailability for use in private treble damage suits against the defendants. The treble damages provision in the law permits an injured party to recover compensation for a violation of the antitrust statutes. The possibility of being held liable for three-fold damages is a strong deterrent to those who would risk violation of the law.

The most serious objection to the use of a consent decree has been based largely on the secrecy surrounding the negotiations. The negotiations between the parties and the objectives sought by the government are strictly the province of the defendants and the Department of Justice. The court generally does not examine the decree in detail, but instead approves it upon submission by the parties. Some question as to the desirability of employing this device emanates from the general policy established by Congress that antitrust proceedings be open to public scrutiny. The judicial arm of the government, as a result, is deprived of its function in enforcing and interpreting

the antitrust statutes.

With court opinions nonexistent and findings of fact unnecessary, few judicial precedents can be established under the procedure. Those accused of violations and the public at large are hard pressed to know whether a violation of the law has occurred, or if the remedies are constitutional. The only types of precedent created by consent decrees result from the use of a particular provision in a particular case. Once used, it is generally the remedy employed in the future for similar types of behavior when detected. Whether the precedent thus created is superior to that gained by a litigated decree is debatable.

The use of precedent in antitrust cases may be divided into two categories. On the one hand is the great body of case rulings mainly concerned with what a violation of the law is, while on the other there are a number of cases providing precedent for the employment of certain remedies to correct these violations. The consent decree is almost entirely concerned with the latter body of rules.

NATURE OF THE DECREE

In the field of antitrust administration and enforcement the consent decree occupies a unique position. It has attracted a great deal of attention and generated much public comment in recent years. Such interest is in keeping with its increased use in civil antitrust cases brought by the Federal government under the Sherman Act. The literature concerned with consent judgments approaches this device from varied points of view. No thorough investigation of this procedure has touched upon all the aspects of the problem. In the present article some comments on its use, nature, and history will be followed by some remarks on its limitations.

The first consent decree in a civil action arose in 1906 in a case involving the Otis Elevator Company. The defendants consented to the entry of a decree against them coupled with a general denial of any violation of the act. Since that time the use of consent decrees has become somewhat common. Seventy-four percent of all civil cases initiated by the Department of Justice's Antitrust Division between 1935 and 1958 were concluded in this manner. Although many of these were cases involving small segments of the economy, their number seems to indicate that the enforcement and administration of our anti-monopoly laws is now carried out by negotiation. Since a consent decree arises from arbitration and negotiation and is given little or no examination by the judge, the process has received some adverse criticism. It has been characterized as a possible cover-up for the accused, on the one hand, or, on the other, as a government device to extract all it is able from the defendants regardless of limitations set forth in the law. The secrecy of the entire procedure has also given rise to congressional investigation with political overtones.

Advantages

It is not difficult to understand why the use of the consent decree is growing. The defendant escapes the notoriety of a protracted court case and the need to employ a bevy of defense lawyers. By far the most crucial factor

is the knowledge that a decree of this sort cannot form the basis of a private treble damage suit at some future date.

The federal government also has something to be gained from this process. Results may be forthcoming at a much more rapid pace without the large expenses connected with a court-litigated decree. In addition, the government may be able to acquire specific relief through negotiations that a court might refuse to grant. The uncertain results connected with a lengthy trial and the problems of proof are also eliminated from the picture.

Disadvantages

Consent settlements are, in effect, a compromise between the accused and the government. No formal procedure for the closed bargaining sessions has been developed. The relative strength of the parties in the bargaining sessions is undeterminable. The requirement that the defendant submit the first draft of a decree may place the government in the superior position at these sessions. Once, however, the government has shown a predilection for settling the case in this fashion, it becomes subject to all the difficulties inherent therein. Another vexing question resulting from the use of the consent procedure is what should be the results of the consent decree? The answer to this will depend in part on one's basic antitrust philosophy. Should we expect a decree of this type to have broad industry-wide repercussions, or merely to control a specific defendant's behavior in the marketplace? The relief granted in consent decrees does not present us with any consistent set of principles upon which to base our answer. Since decree procedure is, in most respects, a bargaining session, the outcome generally depends on the relative strength of the parties' positions. The government need not present evidence of violations, and no finding of fact by either party is required. As a result, no one can be sure a violation has occurred, or that the relief sought is justifiable or necessary.

Consent decrees are now a part of our antitrust procedure, and have been upheld in the Supreme Court of the United States. Once entered into they have the same force and effect as a litigated decree. Very little can be done by the defendant once a consent decree has been formalized by the signature of the District Judge. The decree may be overturned on the rather extreme grounds of lack of federal jurisdiction, the presence of fraud, or lack of consent. There are virtually no other grounds. One defense that would be available in litigated decrees is not useful in consent decrees. It is the defense of failure to state and prove the facts and bases of the relief acquired. In consent settlements no proof of any kind is presented, with the result that the facts of the case are never at issue.

Future Problems

One problem in the use of the consent decree bulks large for the future. The government has in the past brought simultaneous civil *and* criminal actions against a defendant. This procedure presents the problem of what to do with the criminal action once the consent settlement is a *fait accompli*. Some writers have felt that the criminal part of the procedure is a club held over the defendant's head

to coerce him into a consent settlement. The defendant's counsel and officers are fully aware of the government's grounds for dismissal of the criminal suit. They cannot help but be affected by its presence, and the price of its withdrawal. Criminal prosecutions generally have been a very small part of the government's antitrust program, with the result that its consent program has been formulated with the criminal actions largely de-emphasized. The fact remains, however, that a threat of a criminal action is some form of undue influence and has its effect on the defendant's decision to settle by consent.

Pre-Complaint Negotiations

An experimental program of pre-complaint negotiations has been instituted by the Antitrust Division in consent decree procedure. No criminal violations are involved and no criminal complaint is contemplated in this procedure. The government initiates an investigation of the activities of the purported defendant, after which he is requested to appear and discuss the evidence gathered against him. The complaint is not filed during these negotiations, and the talks are extremely informal. If agreement on the terms of the settlement is effectuated, a complaint is then filed to fit the terms agreed upon in the negotiations. Additional savings of money and time result from the procedure, with the added benefit that the government has not committed itself in any manner. The role of the judiciary in consent decrees is eliminated almost entirely by this procedure. Any argument that pre-complaint negotiations will lessen it further is unrealistic.

Since the defendant is required to submit the initial draft of a consent decree, a complaint is generally prepared but held in abeyance pending the negotiation sessions. In effect then we already have pre-complaint negotiations in many cases, and the procedure seems to be working rather well. No pre-complaint negotiations are possible, however, if a criminal action is contemplated, for the government desires to avoid the accusation of having used force or duress to obtain a consent decree.

Modification of Decree

Once a consent decree becomes final, the possibility of amending it is rather difficult. The power to modify the decree is retained by the court that entered it. In the case of *United States* v. *Swift & Company*, the defendant was able to convince the District Court that the circumstances under which the consent decree was entered were now changed. The defendants pleaded that the provisions of the original decree were no longer applicable, since the competitive situation in the industry had been altered considerably. The Supreme Court reversed the decision, holding that considerably more was required to alter a decree once it had been entered. Irreparable injury was indicated as being the basis for alteration or modification of a decree. Other grounds have from time to time been stated, for example lack of consent, lack of jurisdiction, or mistake of fact.

In two important consent settlements involving automobile finance companies the Supreme Court was faced with the same problem. In *The Chrysler Corporation* v. *United States*

the court reiterated its "strict hardship" theory. In *The Ford Motor Co. v. United States* the Court also held that the party seeking the modification must prove extreme injury before it will grant a change in the original decree. At the present time Swift and Company is again seeking modification of the decree entered in 1920. Swift again claims that the decree provisions are no longer pertinent to the situation, and further, that a relaxing of the prohibitions will enhance competition in the industry. The decree, as they see it, is now discouraging competition rather than encouraging it. The question of how long a consent decree is in effect has not been entirely settled. Once entered, however, the decree is binding on all who sign it and terminates the litigation completely. The defendants are not thereby immune to further suit for other activities, and may be subject to further action by the Antitrust Division at a later date.

PROCEDURE AND OBJECTIVE

Although consent decrees have become the accepted mode of settling the majority of antitrust cases, and typically there is no opinion or trial in a court of law, a consent judgment has the same impact as a litigated decree. Consent judgment negotiations are conducted with great informality. The experience of the past thirty years has shown many advantages to sitting down in a private room across the table from defense counsel where the answers to problems can be hammered out as they arise. The facts can be quickly obtained and the appropriate type of relief can be formulated in an amicable atmosphere. Such is not the case in the contentious atmosphere of the court room, where the formalities of court procedure would restrict the proceedings considerably. Counsel for the defense may make statements regarding facts and disclose in complete confidence data during these negotiations with the knowledge that they can never be used in a court case against him. The procedure lends itself well to antitrust cases because the government's investigation brings to light only the defendant's violation and not the details of his operation.

As we noted previously, consent judgment negotiations generally start after a complaint has been filed by the federal government, although a new method of initiating negotiations before the filing is now being tested by the Department of Justice. When full agreement has been attained, the consent decree is prepared in final form and signed by the parties. It is then presented to the District Court by both parties, signed by the judge, and entered as a judgment of that tribunal.

Flexibility

A civil antitrust suit is not conceived from the point of view of a penal action. Criminal suits are brought for this purpose. Nevertheless, a civil antitrust action has as its objective a set of remedial provisions. The desirable effect is to create a situation where the transgressions of the antitrust law will be eliminated and future violations prevented. The judgment is merely the instrument employed in a particular case to eliminate or prevent the civil violations of the antitrust laws. The Supreme Court has stated that each case must be decided on its own set of facts. The age-old doctrine of *stare*

decisis serves rather poorly in questions of relief in antitrust situations. Violations of the antitrust laws have taken an infinite variety of forms. The necessity for employing a corresponding diversity in the forms of relief in the judgments is, therefore, obvious. The equitable powers of the courts are sufficiently adaptable and flexible to cope with the myriad violations facing the government. The Antitrust Division attempts to frame the provisions in the decree to cope with the specific acts of the accused. A serious problem faces the government in providing the necessary relief in these cases. Are the provisions of the decree of such a nature that a court would hold them constitutional?

Guiding Principles

The provisions in a consent judgment do not originate with the judge. This does not mean that there are no precedents upon which to base the provisions of future decrees. Little discussion on the method or type of relief can be found in the district court opinions. However, some general principles have been enunciated to guide the negotiations. A modicum of uniformity is suggested in the decisions, especially when coping with the same type of antitrust violation. The court has stated that the relief must be fair and effective in eliminating the illegal behavior and preventing its recurrence. The Sherman Act is mainly concerned with the nation-wide barriers to interstate trade, and is directed toward dissolving all illegal obstructions to free competition. The remedies are phrased not only to stop illegal acts and prevent their repetition in future, but also to deprive the defendants of the benefits of their illegal acts. In several instances the court has stated that the prohibition of past acts is not enough: the "untravelled roads" must also be prohibited. Of necessity, the court has followed a policy of encouraging remedies of a self-enforcing nature, requiring little judicial supervision. The judge in the International Salt case expressed it succinctly:

> In an equity suit, the end to be served is not punishment of past transgression, nor is it merely to end specific illegal practices. A public interest served by such civil suits is that they effectively pry open to competition a market that has been closed by defendant's illegal restraints. If this decree accomplished less than that, the government has won a law suit and lost a cause.

The Judgments and Judgment Enforcement Division of the Department of Justice has stated the essential purposes of the decrees: to prohibit past illegal activities, to prevent future ones, to restore a competitive climate, and to deprive the defendants of their illegal gains. The Sherman Act does not limit the methods of accomplishing these broad purposes. Whether it is a consent decree or a litigated one, the ends are the same. In a consent settlement the results are accomplished through negotiation in a much shorter time than in a litigated case. With budget limitations as they are the use of this method will continue in use to settle the great bulk of our antitrust cases.

EFFECTIVENESS

Antitrust enforcement, nevertheless, discloses some serious deficiencies when accomplished through consent decrees. This is not to say that the consent de-

cree device should be abandoned entirely, but rather that certain portions of the procedure should be amended to bring the efficacy of such settlements into line with the desired results. If the antitrust laws are to be effective, they must be rigorously enforced by the government. This has not been the case in the past. The consent decree program, however, is but one of a whole parcel of administrative responsibilities of the Antitrust Division. It cannot be condemned for failure in this area without realization of the tremendous job to be done.

The increased tempo in the use of this device is based partially on a policy decision designed to achieve a broad application of the antitrust laws within the limits of available time and money. The savings that result from the use of the consent settlement make possible a more comprehensive total program of enforcement in the antitrust sphere. The judiciary is eliminated from the picture, with a concomitant decline in the growth of judicial precedent. The yardsticks furnished by court decisions are desirable, if only to measure comparable activities in other industries. Under the consent decree a pseudo-administrative procedure is substituted for the judicial procedure. There are no rules to protect the public interest or the interests of those not heard in the settlement conferences. This feature of a consent decree, though not an inherent defect, deprives the business community and the bar of the opportunity to have practices attacked by the government judicially evaluated.

Avoidance of Damages

The possibility that a company will be held liable in a treble damage case is also eliminated with the use of a consent decree. The treble damages provision is a powerful tool to deter violations of the act. In several recent cases the amounts involved have been substantial. Officials of the defendant enterprises considered the possibility of abnormally high damage payments when they decided to submit to negotiations. Corporate officials are in an extremely good bargaining position in these instances. They may formulate a program of action with some doubt as to its validity under the present interpretations of the law. After they are accused of a violation, they may submit to negotiations for a consent settlement and discover their position is a difficult one to defend. At this juncture they may consent to cease such activities, or they may discontinue the negotiations, forcing the government into a lengthy trial of the issues. If the government fails to proceed against them, they may feel secure that, at least for the time being, they may continue their present mode of behavior.

Avoidance of Difficulties

Antitrust litigation is traditionally a very long-drawn-out affair. The complicated problems of proof of legal and economic issues make it extremely difficult for the government to proceed against a defendant. A private party has even more difficulty in bringing an action to a successful conclusion against a violator. If we deprive him of a decree he might have used as *prima facie* evidence in his case, his position becomes virtually untenable. In weighing the decision to proceed to trial of the issues, the accused may

consider the possible future course of his competitors. If the consent decree would contain approximately the same penalties as a litigated one, the consent settlement is eminently more desirable for the accused. The case can be settled amicably, there will be little notoriety, and little danger of private antitrust action.

Despite its defects, the consent decree works fairly effectively in our mixed economy. It directs our attention to keeping open the channels of commerce, and allows prompt steps to be taken against those who would attempt to close them. So far, no other legal device has been so successful in accomplishing these purposes.

Books in Brief

GRAHAM, BENJAMIN. *The Intelligent Investor.* 2nd revised edition, New York: Harpers, 1959.

Since its first appearance, this investment guide has continued to win increasing praise from the professional investor and the public. Because of the author's contention that investment theory and practice must be constantly adapted to economic conditions, this edition has been extensively revised. The author considers the needs of both the "defensive" and the "enterprising" investor, while stressing the advantages of a simple portfolio policy.

ABRAHAMSON, JULIA. *A Neighborhood Finds Itself.* New York: Harpers, 1959.

Our society is faced with the problem of what to do with urban areas. This book tells what one neighborhood did in order to save itself from deteriorating into a slum. As the difficult problems of the Hyde Park-Kenwood area of Chicago's South Side are similar to those encountered by other neighborhoods, this book will be of particular interest to many city-dwellers.

PEARSON, LESTER B. *Diplomacy in the Nuclear Age.* Cambridge: Harvard University Press, 1959.

Are the problems of diplomacy any different than those of a century ago? It is the contention of the author that at present we may have hours or less in which to settle international questions, instead of weeks or months, as in the past. Hence it is important that there be some striking changes in the practice of diplomacy. The author discusses the important role of the United Nations in fostering new diplomatic procedures appropriate to the present day.

YODER, DALE. *Personnel Principles and Policies: Modern Manpower Management.* 2nd edition, Englewood Cliffs: Prentice Hall, 1959.

This new edition of one of the most widely read books in the field has been brought completely up to date. Among the many important topics discussed are management development programs, auditing, industrial relations, the Human Relations School, and recent research in organization theory.

SALVADORI, MASSIMO. *The Economics of Freedom: American Capitalism Today.* New York: Doubleday, 1959.

In recent times American capitalism has been under attack from many quarters. Americans believe that capitalism is not decadent and does not enslave the worker, but often have trouble in saying why. In this book the author has given us an answer. While Mr. Salvadori admits that our system has faults, he points out quite clearly that it is probably the best economic system in the history of mankind.

BERLE, ADOLF A., JR. *Power Without Property.* New York: Harcourt, Brace, 1959.

Why is economic power concentrated in fewer and fewer hands when more and more people are investing their own funds? Why do liberals condemn bigness in business when America has, through bigness, developed the most remarkable economic system in modern history? Mr. Berle discusses such questions as these in his thought-provoking book. An especially useful part of his exposition is a consideration of what features the American and Russian economic systems have in common.

READING FOR BUSINESS AND PLEASURE

Moral Philosophy

Professor Selekman begins his book on moral philosophy for management with a consideration of the change of attitude on the part of business men toward moral questions.[1] From an early reliance on the writings of Adam Smith, Malthus, Ricardo, and Darwin, business has moved toward a new philosophy of moral responsibility based on the recognition by business that it must join the larger human community and even assume ethical leadership in this community. Having shown the pressing need for a moral philosophy, he discusses some of the problems and dangers connected with spelling it out. Self-righteousness, cynicism and perfectionism are described as dangers to be avoided in working out an adequate ethical creed. The last two parts of the book describe a technical and moral framework within which Professor Selekman believes business can formulate its moral philosophy. The final chapter concludes:

> Unless the new and rapidly growing management group holds on to social and moral goals, it is doomed to lose what it now has in the way of authority and opportunity. Private enterprise in the form of the modern corporation has still to win the prize of legitimacy. The prize will continue to prove elusive without a growing faith in the community that, whatever the faltering, justice, and the good life can best be realized through a decentralized industrial system manned by individuals of high purpose responsive to the ethics of our Judaeo-Christian tradition.

The implementation of this ethic is to be what Professor Selekman calls "corporate constitutionalism." Such a constitutionalism amounts to a framework or system for dealing in an orderly, effective way with the conflicts which arise between various segments of industry such as production employees, the white-collar group, engineers and technicians and top management. But there is another side to constitutionalism. This is the relation between government and business. What is demanded here is a strategy of combined operation among corporations, unions, and government. It behooves businessmen to become friendly critics but not opponents of government intervention. To understand the meaning of this last sentence is to understand the moral philosophy here presented for management insofar as this philosophy relates business and government.

With this bare and skeletal outline of the work I turn now to some critical and appreciative remarks about its substance.

In Chapter One of this book its author tells us:

> In recent years, businessmen have come to realize that they must find a way of interpreting themselves in a manner which would make our industrial system consistent with American democracy and the Judaeo-Christian tradition.

1. Benjamin M. Selekman, *A Moral Philosophy for Management*, New York: McGraw-Hill, 1959.

I take it that such an interpretation is what Professor Selekman means by a moral philosophy and that this book is to give the businessman help in formulating such a moral philosophy. If this is the case I find the book unsuccessful; for although it is a perceptive and wise book in many respects, the set of norms and procedures it advocates are not consistent with either democracy or the Judaeo-Christian tradition. As a philosopher who tries to see things as they are and to follow the argument wherever it leads, I feel no distress about these inconsistencies. It may well be the case that both democracy as we have known it and the religious tradition which has characterized our country's history need overhauling. In this case we should get on with the job of overhauling them and not waste time and strength trying to make things consistent which are in their very nature inconsistent.

If one wants recommendations about formulating a reasonable set of procedures for settling labor-management disputes then he will certainly profit from Professor Selekman's book. This book contains the fruits of many years of practical experience and should certainly be taken seriously. Thus, while I am not in the least persuaded that the moral philosophy under consideration is consistent with democracy and religion I think it has much to recommend it and would strongly urge its adoption by management.

Let me make my case more explicit. In any objective reading of the Judaeo-Christian tradition there is no question about the priority of economic and human values. In any conflict between property interests and human interests the latter are considered higher. However, in Professor Selekman's moral philosophy these values are reversed. The Corporation has to stay in business and a manager or president who takes religion seriously is soon going to be out of a job. Our author's advice in effect is: "Don't worry too much about humanity. After all, business is business." Lest this sounds unfair let me quote from the chapter called "Power and Amorality."

> To hold up a standard of applying in any literal sense to workaday life the teaching of the Judaeo-Christian tradition is to put an impractical, if not impossible burden upon management. It is tantamount to no less than projecting the executive group into a situation of perpetual sinfulness. Indeed, an executive may, under these circumstances, develop a pervasive sense of guilt. He may become immobilized for practical action, incapable of giving his best to the community.

It would be hard to imagine a more straightforward denial of the moral philosophy of the Judaeo-Christian tradition and yet Professor Selekman is presumably making this tradition consistent with our industrial system. It is a strange consistency, indeed.

When we turn from religion to democracy the case is about the same. In Part VI: "Wanted—A Moral Framework," we read under the topic "Democracy Reconsidered" this passage:

> Perhaps it is just as well, as we scrutinize the workings of democracy in government, business, unions, or whatever the institution, to admit that in its pure sense democracy, like morality, is an aspiration rather than a living, everyday reality.

But we are left with little doubt as we finish this book that industry has no business aspiring to pure democracy. The fact that corporation presidents are not responsible to the public for their jobs is taken to be both un-

democratic and good. Professor Selekman gives no indication at all that corporations *ought* to aspire to a more democratic form.

Thus the book we are considering fails on one level but this does not keep it from giving management much useful advice. The sort of constitutionalism which its author recommends for the administration of industry would be a big and important step forward. It would not produce utopia but its author does not claim this for it. I am not sure that this constitutionalism is not held back rather than advanced by the sort of moral schizophrenia which results from pretending that our industrial system is consistent with pure American democracy and the Judaeo-Christian tradition. Such pretense results, it seems to me, in exactly the sort of cynicism and perfectionism which the author warns against.

A word should certainly be added about the amount of scientific and factual information one will find in this book on moral philosophy. It is not a moralizing book, but it is a wise one; and it is wise because of the knowledge the author has of his subject. One might wish that all men who write on moral philosophy knew as much about sociology, psychology, economics, and industrial relations as is known by Professor Selekman.

A Moral Philosophy for Management is a good book and it deserves a wide reading. A philosopher cannot but be glad to see the interest which industry has recently shown in philosophy. It is hoped that philosophers will return the compliment and show a comparable interest in industry.

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Arms and the State

In his newest book, Walter Millis continues the analysis of the evolution of American military policy started in *Arms and Man*, his 1956 "Study of American Military History."[1] On the whole, *Arms and the State* is a better book, and certainly one of more immediate interest to business men and students of business. Millis' view of the interdependent and mutually sustaining interests of industry and the military is posed against the whole background of civil-military affairs since the second World War.

He says, "The civil and military elements in our society have become so deeply intermeshed that neither the uniformed officers nor the administrative bureaucracy nor the representative legislature speak from any firm, independent position of principle or policy." The book contends that this condition has arisen despite the traditional subordination of the military to the civil administrator, both at home and in the great areas of international relationships. The author examines the efforts made to resolve the problem during the post World War II years, and concludes that our organizational and institutional structures are still inadequate in the face of nuclear dilemma.

Walter Millis, a *New York Herald Tribune* staff writer from 1924 to 1954, brings to his books the skillful pen of the professional journalist, and with it, the objectivity that 30 years as a working newspaper man engenders. In *Arms and the State*, he has the additional advantage of the research and

1. Walter Millis, with Harvey C. Mansfield and Harold Stein, *Arms of the State*, New York: The Twentieth Century Fund, 1958.

scholarly efforts of his two collaborators. Harold Stein of Princeton and Harvey C. Mansfield of Ohio State have made important contributions in authorship and editorial effort.

The book is presented in two parts. The first and shortest surveys civil-military relations during the 15 years 1930-1945. The second analyzes the events of the period from the close of World War II through 1957. Millis claims that the nation's basic military policy since 1947 has been "framed around the dreadful, and in most situations inapplicable, . . . concept of 'strategic' bombing with mass destruction weapons." While acknowledging the deterrent effect of "the bomb," he condemns the policy of basing our whole defensive posture around it. In his chapter "Cold War," he says, ". . . the strategic Air Force was to prove a nearly useless military instrument. It could not help in a situation like that presented in Greece; it could not stay the Communist conquest of China; it was of no value in the field in Korea; we did not dare use it in Indo-China." Like other commentators during the past two years, Millis believes the country needs to take a new look at the "nuclear fallacy" in light of our lesser capability for the more likely limited war on the ground.

Arms and the State inevitably will be compared with a book of similar title and concept, Samuel P. Huntington's *The Soldier and the State,* published by The Harvard University Press in 1957. Both books are good. Huntington's, subtitled "The Theory and Politics of Civil Military Relations," is a more definitive work, and it covers a much greater span of time in tracing the development of military professionalism in the United States. It is over-simplification to say that Huntington's study has a "conservative orientation," and Millis' a "liberal orientation," but this may help in placing the two volumes in perspective. Either or both of them will provide a solid base for constructive thinking about civil-military policy and the cold war.

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Travelling as I did in 1845-6, through a large part of the Union, immediately after the close of the protracted contest for the presidency, when the votes in favor of Mr. Clay and Mr. Polk had been nearly balanced, I was surprised to find in the north, south, and west, how few of the Americans with whom I conversed as travelling companions could tell me to what denomination of Christians these two gentlemen belonged. This ignorance could by no means be set down to indifferentism. . . . It was clear that in the choice of a first magistrate their minds had been wholly occupied with other considerations, and the separation of religion and politics is certainly one of the healthy features of the working of the American institutions.

Sir Charles Lyell, *A Second Visit to the United States of North America,* New York: Harpers, 1849.